Saskatchewan
Local Government
Finance
Commission

Alternative Local Sources of Revenue and Utilization of the Property Tax Base

Interim Report of
the Local Government
Finance Commission
September, 1985

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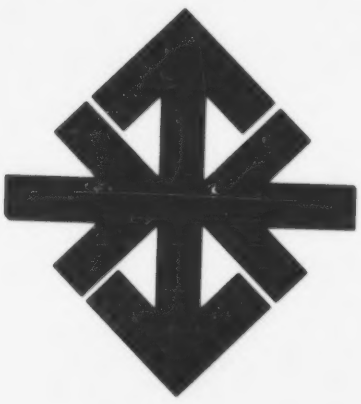

Saskatchewan

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Local Government
Finance
Commission

3211 Albert Street
Regina, Canada
S4S 5W6

September, 1985

Honourable Bob Andrew, Chairman
Cabinet Committee on Local Government Finance
Room 312
Legislative Building
Regina, Saskatchewan
S4S 0B3

Dear Sir:

We have the honour to submit the report of the Local Government Finance Commission on alternative local sources of revenue and utilization of the property tax base.

This report is issued concurrently with Property Assessment in Saskatchewan, another interim report of the Commission.

This report deals with potential local sources of revenue for local governments, however, options under which revenues collected by senior governments could be made available to local governments will be fully analyzed in a subsequent report.

Commissioner Thiessen disagrees with the Commission's conclusion that school divisions should continue to have access to the property tax base for a portion of their revenue, partly because of his view about what constitutes local government. For this reason, he had declined to endorse the report.

Commissioner Brady, has also declined to endorse the report. His position is that education should be removed from the property tax. However, as a compromise he is prepared to accept the positions suggested by the Saskatchewan School Trustees Association, the Saskatchewan Teachers' Federation and the majority of Saskatchewan cities that school divisions should have access to the property tax for some of their revenue, but that a much higher percentage, such as 75% to 80%, of education costs should be funded by the provincial government. He believes that this proposal, other options under which revenues collected by the senior governments are transferred to local government, and the contents of this report, should have been included in a more comprehensive report which could be issued at a later time, once the required analysis had been completed.

Commissioners O'Shaughnessy, Volk, Wright, Langlois, Linner and Clayton agree that the category of options mentioned by Commissioner Brady need to be explored, but took the position that this report should be issued now for two main reasons. First, the Commission's conclusions that the property tax is the only local revenue source of sufficient magnitude to meet the needs of local government, and that both school divisions and municipalities should continue to have access to the property tax for a portion of their revenues, provided the foundation for certain important components of the Commission's report on property assessments. They believe that the background and rationale for these conclusions should be available prior to or concurrently with the report on assessments. Secondly, they believe that the issuance of this report at this time in no way encumbers the Commission in doing a thorough examination of these other options for release in a subsequent report.

Respectfully submitted,

Ray Clayton
Chairman

Nick Volk
Commissioner

Herve Langlois
Commissioner

Lol O'Shaughnessy
Commissioner

John Wright
Commissioner

Bob Linner
Commissioner

Ike Thiessen
Commissioner

Ted Brady
Commissioner

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PREFACE

The Local Government Finance Commission was established by the Government of Saskatchewan under *The Public Inquiries Act* by Order-in-Council #635/84, dated May 23, 1984. The Commission was given a two year mandate to inquire into a broad range of issues relating to the financing of local governments and to identify options for addressing those issues. Among the matters being examined by the Commission are:

- capital requirements and funding mechanisms;
- provincial-municipal revenue sharing;
- financing elementary and secondary education;
- property tax structure;
- role of property tax rebate programs;
- alternative revenue sources;
- local funding of hospitals;
- local funding of libraries;
- assessment principles and processes;
- property tax collection processes;
- tax abatements;
- commercial-industrial property tax sharing; and
- possible shifting of program responsibilities.

The Commission consists of eight members:

- Ray Clayton, Chairman, former Deputy Minister of Urban Affairs and Deputy Minister of Education;
- John Wright, Vice-chairman, Director, Social Programs, Treasury Board Division, Department of Finance (replaced Don Rowlatt as of June 12, 1985);
- Ted Brady, Past-president of the Saskatchewan Urban Municipalities Association and Past-president of the Federation of Canadian Municipalities, representing S.U.M.A.;
- Ike Thiessen, Vice-president of the Saskatchewan Association of Rural Municipalities, representing S.A.R.M.;
- Nick Volk, Past-president of the Saskatchewan School Trustees Association, representing S.S.T.A.;
- Lol O'Shaughnessy, business person, member-at-large;
- Herve Langlois, Deputy Director of Education, Saskatoon Public School Division, member-at-large; and
- Bob Linner, Prince Albert City Commissioner, member-at-large.

The Commission is appreciative of the excellent contribution to its deliberations by Don Rowlatt who served as member and Vice-chairman of the Commission from May, 1984, to June, 1985.

The Commission reports to a Cabinet Committee comprised of the Honourable Bob Andrew, Minister of Finance (Chairman); the Honourable Tim Embury, Minister of Urban Affairs; the Honourable Louis Domotor, Minister of Rural Development; and the Honourable Patricia Smith, Minister of Education. The Commission meets occasionally with the Cabinet Committee to inform the Committee of its work to date and future plans. At the first meeting, the Commission was encouraged to report on its findings in a series of interim reports rather than to wait until the end of the two year mandate to issue one large final report.

The Commission began its work in June, 1984. During the Fall of 1984, it held a major conference entitled "Options for the Future" in the Legislative Assembly Chambers in Regina. Five major local government organizations, the Saskatchewan Urban Municipalities Association (S.U.M.A.), the Saskatchewan School Trustees Assocation (S.S.T.A.), the Saskatchewan Association of Rural Municipalities (S.A.R.M.), the Saskatchewan Health-care Association (S.H.A.), and the Saskatchewan Library Trustees Association (S.L.T.A.), were invited to participate in the conference. As well, a number of other interested organizations and provincial government departments and agencies were invited to attend as observers.

Following the conference, the Commission held regional meetings in 11 communities in order to give local groups and individuals an opportunity to express their concerns and ideas. A total of 126 briefs were presented at the regional meetings and an additional 33 briefs and 13 letters were sent directly to the Commission.

Most of the Commission's work over the first six months was devoted to consultations with local government organizations and the public in an effort to identify and understand the issues and concerns about local government finance.

The January, 1985 *Interim Report* outlined what the Commission heard about issues and concerns during a series of meetings held across the Province, described what the Commission considered to be the fundamental issues, outlined some initial recommendations and conclusions, and described the areas the Commission would be addressing in the future.

This interim report addresses the questions of alternative local revenue sources and utilization of the property tax base.

Subsequent to the issuing of the January report, several members of the Commission attended the S.U.M.A. convention in January, S.S.T.A. seminars in Saskatoon and Regina in February, and the S.A.R.M. convention in March. During these meetings, the Commission outlined its first interim report and its current activities.

Meetings were held with the Saskatchewan Assessment Authority and the Departments of Rural Development, Education, and Urban Affairs on May 15 and with elected and administrative local government personnel on May 16 to discuss governance of the property assessment function and valuation principles. These subjects are dealt with in a separate interim report.

Meetings were held with representatives of S.A.R.M., S.S.T.A., and S.U.M.A., in June to discuss property assessments, alternative local revenue sources and utilization of the property tax base.

In addition to the above-noted consultations, the Commission met for 15 other days to discuss information that had been assembled and to consider options for addressing the issues under review.

Prior to the June meetings, the Commission distributed discussion papers to the representatives of S.U.M.A., S.A.R.M., and S.S.T.A. who were to attend the meetings, in order to provide background information and promote familiarization with and discussion of concepts being reviewed by the Commission. The question of which types of local government should have access to the property tax proved to be the most contentious issue.

In regard to the question of utilization of the property tax, the Commission identified and analyzed 18 different considerations which it felt should provide the basis for arriving at conclusions regarding the issue of utilization of the property tax. During the June meetings, the Commission several times asked two important questions of the representatives:

- Had the Commission identified in the discussion paper all of the considerations or factors which should be evaluated in arriving at conclusions on the matter at hand?
- Was the Commission's evaluation of those considerations in the discussion paper valid?

As a result of these discussions, the Commission is confident that it has adequately identified and evaluated the relevant considerations required to arrive at sound conclusions regarding utilization of the property tax.

The Commissioners have felt strongly from the beginning that it is incumbent upon the Commission to obtain the most current and complete information available and to undertake a thorough review and analysis of all options. The opinions and proposals of all contributors have been treated with the utmost respect and have been given full and fair consideration by the Commission.

The Commissioners believe that to meet the responsibilities and obligations placed upon them as members of a public inquiry it is necessary to conduct their business in an open, participatory manner and to share widely their findings and conclusions.

The Commission is thankful for the willingness of local government organizations to meet with the Commission on numerous occasions and to provide their suggestions and comments.

The Commission will be reviewing the important topics of provincial-municipal revenue sharing program, the school foundation grant program, local funding of hospitals and libraries, capital needs and capital funding requirements, industrial and commercial tax sharing, grants-in-lieu of taxes and other topics over the balance of its mandate.

CHAPTER I
INTRODUCTION

This interim report addresses two major topics:

- alternative local revenue sources which might be used to finance local government services, either as replacements for the property tax or as supplements to it, and
- utilization of the property tax base, including the overall extent to which the property tax should be used to fund local government services, as well as which particular local governments should utilize the property tax.

It is estimated that in 1985, approximately $625 million will be raised by property taxes and grants-in-lieu of taxes collected by local governments. School divisions account for about 51% of this total, municipalities about 45%, and hospital and library boards about 2% each. Of the total municipal share of 45%, rural municipalities account for approximately one-third and urban municipalities the remaining two-thirds.

The $625 million in total property tax is comparable in magnitude to each of the two largest revenue sources for the provincial government in 1985, the personal income tax which is projected to yield $626 million, and oil revenues which are projected to yield $655 million. The magnitude of the property tax alone, makes the issue of alternative local revenue sources and utilization of the property tax base very important.

In Chapter II the Commission addresses the question of alternative local revenue sources. Some have suggested alternative forms of local taxation which could be utilized by local governments to supplement or even replace the property tax. This chapter will identify and evaluate these potential local revenue sources.

Chapter III is a description and analysis of various criteria or considerations which can be used in analyzing the utilization of the property tax. Numerous considerations have been suggested to the Commission and the Commission has identified others. Each of these criteria is examined in regard to its validity, relevance or usefulness, and on its relative importance.

Chapter IV summarizes the main observations and conclusions reached by the Commission.

The Commission has addressed the issues in this paper as they relate to rural, urban and northern municipalities and school divisions. The governance and funding of hospital and library boards are important areas requiring further analysis before the Commission will be ready to reach conclusions and make recommendations. These areas will be dealt with in a subsequent Commission report. The conclusions reached by the Commission in regard to municipalities and school divisions may or may not be applicable to hospital and library boards.

CHAPTER II
ALTERNATIVE LOCAL SOURCES OF REVENUE

This chapter explores alternative local sources of revenue which might be made available to local governments either as replacements for, or as supplements to, the property tax. The possibilities examined include the S.A.R.M. proposal for a tax on basic income, income taxes, sales taxes, amusement taxes, hotel occupancy taxes and land transfer taxes.

1. FOUR MAIN ELEMENTS

There are four main elements involved in the utilization of a particular revenue source:

Defining the Tax Base

The tax base must be defined before taxation can proceed. In the case of the sales tax, the services or commodities which are either exempt from or subject to the tax must be determined. In the case of the income tax, there must be a definition of what constitutes income, what constitutes allowable deductions from income and how taxable income is determined. In the case of the property tax, rules are required to determine what property is taxable or exempt throughout the Province, and the basis of appraising the property.

The question arises as to the level of government which should be responsible for defining the tax base. The Commission has concluded that although it might be possible to have each local government define the base for each tax it levies, this would not be desirable because of the inconsistencies and confusion which would ensue. Instead, the tax base should be determined on a province-wide basis, either by the provincial government or by a body which could be given the authority to make such decisions. In this way, there would be consistency throughout the Province and there would be less complexity in the tax system.

Setting the Tax Rate

Once the tax base has been defined, decisions are required on the rate of taxation. Tax rates could be determined individually by each local government or a standard tax rate applicable to all local governments could be determined by the provincial government or some other body which could be given the authority to do so.

Local governments levy taxes in order to meet local needs and, accordingly, there is usually some variation in the tax rate from local government to local government. Determining services and expenditure levels and making decisions on local rates of taxation are two fundamental functions of local governments. In the view of the Commission, a tax cannot be regarded as a local tax unless the local government has the authority to set the tax rate. If the provincial government or some other body sets a common tax rate, the tax is not a local tax, even if the proceeds are remitted to the local governments.

Administering the Tax

Once the tax base has been defined and the tax rates have been set, the taxes must be collected. Administration of the collection of taxes includes monitoring collections, auditing the returns of those who pay the tax or who are responsible for remitting it, and enforcing collections, including the prosecution of violators.

The administration of some types of tax collections (like the property tax) are relatively straightforward and administratively feasible at the local level. Other types of taxes (like the income tax) are more complex and are feasibly administered only by larger central administrations with the specific expertise and resources required.

The Commission believes that a tax administered by another body or by the provincial government still meets the requirements of a local tax provided that the tax rate is set by the individual local government. The Commission also recognizes, however, that the separation of the rate-setting and collections functions tends to make it more difficult for the taxpayer to understand who makes the decisions on taxation and who can be held accountable for those decisions. In other words, a tax administered centrally may not be perceived by the individual taxpayer as being a local tax.

Distribution of the Proceeds

There are several ways in which the proceeds of a tax can be distributed. If individual local governments set their tax rates and administer their own tax collections, they retain the proceeds. If the provincial government or another central body administers a tax for which individual local governments have set the rates, it seems logical that the proceeds would be allocated to the respective local governments where the revenues were collected. If the provincial government sets a tax rate for the Province (this would be a provincial rather than a local tax), and decides to allocate some or all of the revenues to local governments, it could distribute the proceeds in accordance with a formula (e.g. per capita, municipal revenue sharing formula or school foundation formula).

2. DIVISION OF RESPONSIBILITIES

The Commission has identified three main options for the division of responsibilities under which new or expanded revenue sources could be used to finance local governments. In each option, it is assumed that the provincial government would define the tax base.

Option 1

The provincial government could:

- set a common tax rate for the entire Province;
- administer the tax; and
- distribute the proceeds among local governments under a formula.

This option could be used to increase provincial funding of local governments and reduce the degree to which they must rely on the property tax. It could not be used to replace the property tax entirely without denying local governments a meaningful locally determined source of revenue, unless local governments gained access to another substantial local revenue source.*

Option 2

The individual local government could:

- set the tax rate for its own area.

The provincial government could:

- administer the tax; and
- distribute the proceeds to the local government of origin.

Because the key decision involved in this option (setting the tax rate) would rest with the individual local government, the tax could be considered a local tax and this option would be consistent with the requirements of local autonomy. There is a danger, however, that the public may find this division of responsibility confusing, thereby impairing accountability for taxation decisions.

Option 3

The individual local government could:

- set the tax rate for its own area;
- administer the tax; and
- retain the proceeds for its own use.

This type of tax would be considered a local tax and this option would also be consistent with the requirements of local autonomy and accountability.

3. TAXES BASED ON INCOME

A. Historical Background

1) Canada

Municipal income taxes started in 1831 in New Brunswick, well before either federal or provincial income taxes. Montreal and Quebec City adopted a form of of income tax in the 1850s. In Ontario, income was defined and taxed as personal property beginning in 1850 and, in 1904, income became subject to a municipal income tax. In most cases, municipal income taxes were levied at a flat rate, although Montreal did have progressive rates. Until 1930, local income taxes yielded more than provincial income taxes. Local income taxation ended in Canada in 1941, with the adoption of the Wartime Tax Rental Arrangements.

2) United States

Local income taxes are relatively common in the U.S.A. In 1976, 4,200 jurisdictions in 11 states imposed an income tax. Such taxes are most widespread in Pennsylvania, where 3,500 municipalities and school districts levy the tax. Elsewhere, local income taxes are used mostly by large cities.

Municipal income taxes are of growing importance as a source of local tax revenue. In 1978, income taxes contributed 5.3% toward total local tax collections. In the 13 largest cities in which an income tax is used, it generates an average of 27% of local tax revenue.*

In the U.S.A., local income taxes are generally determined and administered locally. Hence, local income taxes take many different forms in that country. The tax is usually simple, being based on earned income at low, flat rates. However, in some cases, the local tax is collected by the state or the state defines the tax base which all local governments levying the tax must use. Wages and salaries are most often used as the tax base and while this makes the tax relatively simple to administer, it also means that there are inequities in the tax load because incomes earned in other ways are not taxed. Some large cities do, however, tax investment income. Business income is taxed in some instances.

3) Scandinavian Countries

Local income taxes are the predominant form of local taxation in Scandinavian countries and property taxes are negligible. The national, county and municipal governments, and the church or parish districts share the income tax field. Local income taxes are based on the national tax base and are collected together with the national tax.

Local rates vary from 15% to 27% throughout the Scandinavian countries, although there is little variation within each country. Tax rates are generally flat and not progressive. Both personal and corporate income are taxed and the tax is paid to the jurisdiction in which the taxpayer resides. National equalization programs exist to reduce fiscal disparities between jurisdictions. One report estimates the cost of administration of the national and local taxes at 1% of total taxes collected.

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* In its January, 1985 *Interim Report*, pp. 24 - 29, the Commission stressed the importance of autonomy for local governments and the necessity of having access to a meaningful source of local revenue to ensure local autonomy.

* From M.L. McMillan and R.H.M. Plain, *The Reform of Municipal-Provincial Fiscal Relationships*, August, 1979.

B. S.A.R.M. Proposed Tax on Basic Income

S.A.R.M. has proposed a tax on basic income to meet the costs of elementary and secondary education. The major arguments advanced by S.A.R.M. for this proposal are as follows:

- The provincial government now exerts substantial control over education, such that there is no longer a relationship between local decisions on education and the local property tax.
- A distinction can be made between "services to people" and "services to property". "Services to property" should be financed from the property tax, while "services to people", such as education, should be financed from the income tax. Further, there is a relationship between earnings and the amount of education received.
- When property taxes are used to finance education, some people do not pay a fair share of education costs. This would be resolved by a tax on basic income.
- Rural property owners bear an excessive education property tax burden relative to their urban counterparts. This inequity would be eliminated by the discontinuation of property taxes for education.

The key elements of the proposed tax on basic income are:

- Basic income would be defined as "the amount of money derived from gainful employment, investment, or business enterprise after direct costs of making that money are deducted". No other deductions would be allowed.
- The tax rate would be flat (not progressive).
- The tax rate would be set by a central authority comprised of elected school officials, which would also allocate the revenues among school divisions, by means of a formula.
- The tax would be collected by a central authority or the provincial government.
- Education would be totally funded from the tax and from other provincial sources and, as a result, there would be no property taxes for education.

1) Yield

If the tax were defined in the same way as the flat tax introduced in the 1985-86 provincial budget, the yield would be about $107 million per annum for each 1% of basic income.

2) Comments on the S.A.R.M. Proposal

The tax on basic income proposed by S.A.R.M. is similar to the flat tax introduced by the provincial government in its 1985-86 budget.*

The provincial and federal governments are currently expressing a great deal of interest in tax reform. It is not at all inconceivable for discussions between those levels of government to lead to further adjustments to the flat tax which would bring it even closer to the concept proposed by the S.A.R.M.. It is also conceivable that the federal government could agree to administer a tax on basic income just as it has agreed to administer the flat tax introduced by the provincial government in its 1985-86 budget, particularly if the tax bases for the tax on basic income and the flat tax were defined identically.

Even though the S.A.R.M. proposal envisaged the provincial government or some other province-wide body administering the tax on basic income, having the federal government administer it along with the "regular" income tax system would not seem to violate any of the basic concepts of the proposal. Having the federal government administer such a tax would be better than having to establish another administrative organization in Saskatchewan to administer it, simply because the additional expense would be avoided.

It is important to note that the S.A.R.M. tax on basic income would not be a local tax. A single tax rate would be established for the Province as a whole, rather than tax rates being set by each local government. If the proceeds from this tax, plus provincial grants, were the exclusive revenue sources for school divisions (or any other local government), they would lose the autonomy that comes with access to a meaningful local source of revenue. Whether the sole source of revenue were provincial grants or payments from a central authority comprised of elected school officials or both, the individual school division would lose much of its autonomy.

Notwithstanding the serious concerns the Commission would have with the S.A.R.M. proposal as a complete replacement for existing funding arrangements for school divisions, the tax on basic income could be used to increase grants to school divisions or other local governments to reduce the extent to which they must rely on property taxes, if this were thought to be a desirable objective. In other words, the S.A.R.M. proposal could be readily used to shift the tax load away from property taxes onto an income-based tax, even if it would not be appropriate to use it as a complete replacement for property tax.

C. Local Income Tax

The fact that the local income tax (L.I.T.) is used in other countries suggests that it should be evaluated for possible use in Saskatchewan.

1) Tax Base

As noted earlier in this report, for purposes of consistency and simplicity, it would be preferable to have the base for a local tax defined by the provincial government. If the federal government were to administer the tax as part of their income tax administration, they too would likely wish to be involved and possibly even make the final decisions in defining the tax base.

The tax base could be basic income as defined in the S.A.R.M. proposal, the base used for the 1985-86 flat tax in Saskatchewan, the traditional income tax base, or some other base.

* See Appendix A for a description of the Saskatchewan flat tax on income.

If the tax base consisted only of wages and salaries, as is the case for numerous local income tax systems in the United States, the tax would be simple and relatively easy and inexpensive to administer either at the provincial or individual local government level. However, this would be an inequitable tax base because farm, business or investment income would not be taxed. Many local governments, particularly rural municipalities, would have little or no tax base to tax.

If all forms of income were to be taxed, the tax would be more fair, but it would also become more complex and costly to administer.

2) Tax Rates

In order for the L.I.T. to be a local tax and to meet the requirements of local autonomy and accountability, it would be necessary to have the tax rates set by the individual local government. The administration of the tax could be done at the provincial or federal level and still meet these requirements.

3) Collections and Administration

While it would be administratively feasible for individual local governments to administer a tax base consisting only of wages and salaries, no further analysis will be made of this option because of the obvious inequities associated with defining the tax base in this way. Although it might be feasible for local governments the size of Saskatoon and Regina to administer a broader income tax base, the complexities and costs of monitoring, auditing, enforcing, the regular processing of returns, and allocating business income among the local governments where the income was earned, would clearly make it infeasible for other local governments.

There are two main options for the central administration of a local income tax:

- The provincial government could establish an administrative capacity to duplicate the functions currently performed by Revenue Canada which currently administers the federal and provincial income taxes.

  This administrative capacity could be used to administer the local income tax and remit the proceeds to the individual local governments.

  This machinery might also be used to administer the provincial income tax (as is currently done in Quebec). Although the Commission has not done a detailed study of the costs of such an operation, it is estimated that the cost to Saskatchewan to administer its own personal income tax would be in the neighbourhood of $30 million annually.* The cost of administering the corporate income tax would be over and above this estimate. The Commission believes that the cost of administering a personal income tax at the provincial level outweighs any benefits from such an arrangement.

- The federal government could administer the local income tax as it does now for provincial income taxes. In addition to the regular requirements of administering the federal and provincial income taxes, it would be necessary to allocate business income among local governments where the income is earned and apply the specific tax rates set by the individual local governments. The Commission has not endeavoured to determine the additional costs to the federal government if it were to administer a local income tax, but it would be less than establishing a separate administrative apparatus within the Province. The fact that the Scandinavian countries administer income tax for three levels of government would suggest that it is feasible from a technical standpoint, even if the costs may be such that it would not be attractive for application in Canada.

  Whether the federal government would be agreeable to enter into discussions that could lead to their administration of a local income tax is not known. However, the Commission notes that both the provincial government and the federal government are currently very interested in the reform of taxation.If this particular option were considered desirable, now would seem to be an opportune time to take some initiative.

4) Yield

The tax would yield an estimated $107 million per annum for each 1% of taxable income if taxable income were defined in the same way as for the new flat tax. If the tax utilized the definition of the "regular" income tax base, the yield would be $12.1 million for each 1% of federal basic tax.

5) Comments on Taxes Based on Income

The Commission believes that the additional cost of a Saskatchewan-based administration of a local (or a local plus provincial income tax) is a strong argument against such an approach. A more viable approach to a local income tax would be to have the federal government administer it along with existing federal and provincial income taxes, although this would add considerably to the complexity of the income tax system in an age in which simplicity is being sought. There would also be substantial additional costs involved in this approach.

* The Ontario Economic Council, in its 1963 report, estimated that it would cost Ontario $120 million annually to administer its own income tax system. Allowing for increases in costs, subsequent to the publication of the Ontario study, and making assumptions on which costs would be proportional to population and which costs would be relatively fixed, an estimate of $30 million annually was determined for Saskatchewan.

Local governments require stability in their income. Local governments are not equipped to deal with substantial swings in their incomes from year to year as are provincial and federal governments with their more varied revenue sources and their ability to borrow substantial sums for operating purposes, when necessary. The income tax is not a stable tax, particularly in a province such as Saskatchewan which is so heavily dependent on agriculture and other primary production which are subject to dramatic changes in income from year to year. Because circumstances vary considerably from locality to locality within the province and from year to year, the income tax would be even more unstable for the individual local government than it would be for the province as a whole.For these reasons alone, the Commission has serious reservations about a local income tax for local government, particularly if it were intended to be relied upon extensively or if it were to replace the property tax entirely for some local governments.

The Commission is of the view that if it is considered desirable to place less reliance on the property tax and more reliance on the income tax, it would be best to have the provincial government tax income at uniform province-wide rates using current administrative mechanisms and pass these and possibly other provincial funds on to local government in the form of grants or revenue sharing payments. This would ensure a minimization of administration costs and would ensure local governments more stability in their revenues, compared with the levying of local income taxes.

4. TAXES BASED ON SALES

Background

Local sales taxes no longer exist in Canada, but did exist from 1935 to 1964 in Quebec. By 1964, 20% of local governments in Quebec levied sales taxes of 1% to 2%. These taxes were collected by the Province and distributed back to municipalities. The Quebec government took over the sales tax field in 1964, because of problems with tax evasion and municipal dissatisfaction with the distribution of revenue.

Local sales taxes are still quite common in the U.S.A., with approximately 4,700 governments in 26 states collecting such taxes, as of 1979. The rates range from 1/2% to 5%, but are typically about 1%. Local sales taxes are the second most important source of local revenues, generating 11% of local government tax revenue in the U.S.A. as a whole, and 17% in those states where it is used. Twenty-six of the 48 largest cities use local sales taxes.*

Tax Rates

If the sales tax were to be a local tax, rates would have to be set at the local level.

Tax Base

For reasons discussed earlier, decisions on the tax base should be made by the provincial government.

A sales tax on fuel could be based either on the volume of fuel sold or the value of fuel sold; both have been used in the past.

Yield

On the basis of the current definition of the sales tax base, each 1% of sales tax in Saskatchewan yields an estimated $65 million. Based on the 1981-82 "on road" consumption of gasoline and diesel fuel, the estimated yield for each one percent of the value of fuel sold would be $8.9 million and the estimated yield for each one cent per litre sold would be $20.1 million.

Collections and Administration

It would be possible from a technical standpoint to have each local government set its own tax rate on the provincial sales tax base, and to have the provincial government collect the tax from retailers and remit the proceeds to the individual local government from where the taxes were collected. This approach would require additional administration and enforcement effort by the provincial government and, hence, higher costs. The provincial government would have to ensure that each retailer charged the appropriate rate of tax for that local government and that the collections applicable to each local government were accumulated and remitted to that local government.

The most complex system with the highest administration costs would be a locally levied and administered tax. Administration and enforcement staff would be required by each local government and computer facilities would likely be required by many local governments to keep track of retailers and the amount of taxes owing and collected. While such a system might be possible to implement from a technical standpoint, the costs would be prohibitive.

Comments

Most sales take place in urban municipalities and relatively little benefit would accrue to rural municipalities from a local sales tax. Sales tax revenues generated by expenditures by rural residents in urban communities would accrue to urban municipalities. Likewise, expenditures in larger centres by residents of small urban communities would provide sales tax revenues for the larger centre.

To the extent that local sales tax revenues replaced local property taxation, greater provincial equalization transfer payments would be required to compensate for the substantial increase in variations in the yield of revenue from local government to local government.

* From M.L. McMillan and R.H.M. Plain, *The Reform of Municipal-Provincial Fiscal Relationships*, August, 1979.

Considering the mobility of most consumers, the Commission would be concerned about the competition among local governments if each were to have the authority to set its own sales tax rate. Such competition could have a major negative impact on the viability of businesses in some centres and on the amount of revenue any one local government could reasonably expect to collect from the source.

If it were considered desirable to place more reliance on the sales tax and less on the property tax, the Commission is of the opinion that in view of distribution of the yield of a local sales tax, administrative costs and competition among local governments, it would be preferable to have the provincial government levy and collect the tax and distribute the proceeds to local governments as grants or revenue sharing payments.

5. AMUSEMENT TAX

Under current legislation, both urban and rural governments are empowered to levy amusement taxes. Such taxes are levied on persons attending a place of amusement as a percentage of the value of the admission price. However, only Saskatoon and Regina currently use an amusement tax and, in total, the two cities collect $1.1 million annually from that source.

Any other municipality has the authority to levy such a tax, although the revenues which could be obtained in smaller centres or rural areas would be limited. The limited yield from this type of tax means that while it can be used as a supplement to existing revenue sources, it can by no means be a replacement for the property tax.

6. HOTEL OCCUPANCY TAX

In its submission to the Commission, the City of Regina proposed a local hotel occupancy tax as a possible additional source of municipal revenue. This would be levied on the amount paid to a hotel or motel for accommodation and the proceeds would be used to promote business conventions, tourism and recreation. Currently, hotel occupancy is subject to the 5% provincial sales tax. A local tax could be applied and remitted to the provincial government for distribution back to the local governments or, alternatively, the tax could be remitted by the hotel owner to the appropriate local government.

The value of hotel occupancy in Saskatchewan in 1983 was estimated at $312 million. Therefore, if every municipality levied a tax on hotel occupancy, each 1% of tax would raise $3.1 million.

There are conflicting considerations in regard to the potential use of this tax source. Whether convention and tourist usage of Saskatchewan facilities would be negatively affected by such a tax is one consideration. Another consideration is that very few rural municipalities would benefit from this form of taxation because there are few such establishments in rural municipalities. Larger communities, with greater numbers of hotels, would benefit proportionally more than smaller communities.

The Commission is not aware of the existence of local hotel occupancy taxes elsewhere in Canada.

On balance, the Commission favours the amendment of legislation to permit municipalities to tax hotel occupancy if they so choose. The Commission also believes that the municipalities should be given the responsibility for determining the rate or rates appropriate to their individual circumstances, and for determining whether the proceeds would be earmarked for particular programs or services.

7. REAL ESTATE TRANSFER TAX

The Ontario and New Brunswick governments levy land transfer taxes. In Ontario, all land transfers to residents are taxed at the rate of 0.4 percent of the purchase price for the first $45,000 and 0.8 percent of the price in excess of $45,000. For transfers of agricultural or recreational property to non-residents, a 20% tax is levied. New Brunswick levies a tax on real property transactions.

In Nova Scotia, municipalities may levy a local land transfer tax of 0.5% and about one-third of the municipalities actually levy the tax. Quebec municipalities are permitted to levy real estate transfer taxes at the rate of 0.3% for the first $50,000 of sale value and 0.6% for the value in excess of $50,000. Legislation in Manitoba permits municipalities to levy real estate transfer taxes, but no rate is set in the enabling legislation and no municipalities have imposed the tax.

In 1982, real estate transactions in Saskatchewan are estimated at $2,250 million. Approximately $2.25 million in revenue would be obtained for each 0.1% of tax, if all municipalities levied such a tax.

A locally levied tax of this nature could be efficiently administered if it utilized a provincial collection mechanism integrated with computerized land titles records.

The Commission does not favour the implementation of a real estate transfer tax for the following reasons:

- because of the volatility of real estate transactions, it would be an unstable revenue source for local governments;
- the yield from the tax would vary considerably from municipality to municipality, depending upon the number of real estate transactions;
- the tax would be collected regardless of whether those involved in the real estate transaction experienced a loss or a gain;
- if the rationale for such a tax is to tax those who generate substantial income through real estate transactions, it would be more equitably accomplished through the income tax system; and
- those who buy or sell their homes relatively frequently, such as persons with occupations requiring frequent transfers, would be affected unfairly by such a tax.

The Commission also notes that the Government of Saskatchewan levies land titles transfer fees, and that these fees exceed the cost of establishing and maintaining the records. In effect, the real estate transfer tax base is already being occupied by the provincial government.

8. RESOURCE REVENUES

Royalties and other proceeds from non-renewable resources are projected to generate in excess of $800 million in revenue for the provincial government in 1985-86. The magnitude of these revenues in itself warrants some comments.

The main observations of the Commission in this regard are:

- resource revenues are clearly not potential local sources of revenue. Such revenues, for the most part, do not fall into the same category as taxation. Decisions on royalties and other revenues from non-renewable resources are closely intertwined with fundamental policies of regulation and development in the respective industries and are clearly the responsibility of the provincial government, not local government;
- resource revenues are very unstable*; and
- the provincial government could share a specified percentage of resource revenues with local governments to enable them to reduce the current reliance on the property tax. The provincial government could also include resource revenues as one of the revenue bases that is used to calculate the amount of change in the revenue sharing pools from year to year.**

9. SUMMARY

Taxes based on sales or income can generate sufficient yield to be used to supplement the property tax in a major way, to reduce the reliance on the property tax substantially, or to replace entirely the property tax for some local governments. However, the Commission sees major disadvantages in these taxes as local taxes, particularly in terms of additional administrative costs and instability in revenues for local governments. If it is thought to be desirable to have less reliance on the property tax relative to the sales or income taxes, it would be preferable for the Province to levy those taxes on a uniform province-wide basis and distribute the monies to local governments as grants or revenue sharing payments. More commentary on the desirability of sales and income taxes relative to the property tax will be made later in this report.

Other forms of local taxation could be used to supplement the property tax, but either their yield is sufficiently small to render them relatively unimportant (i.e. the amusement tax and the hotel occupancy tax), or there are features of the tax which make it undesirable (i.e. the real estate transfer tax).

In short, the Commission has concluded that in regard to those services which require a local source of revenue, there is no practical and desirable replacement for the property tax. This still leaves open the question as to the appropriate level of property taxes relative to other taxes. If it is deemed desirable to reduce the level of property taxes, there are ways of doing so which would still ensure that those local governments which currently use the property tax can continue such utilization.

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* For example, potash revenues amounted to $280 million for the Government of Saskatchewan in 1980-81. In 1981-82 these revenues dropped to $185 million and in 1982-83 they dropped to $37 million, even though the structure of the tax and the tax rates had not been changed.

** The Commission will deal with revenue sharing and the revenue sharing escalator in a subsequent report. The provincial government decided not to include resource revenues in the revenue base used to determine the escalator applied to the municipal revenue sharing program introduced in 1978.

CHAPTER III
UTILIZATION OF THE PROPERTY TAX BASE: SOME CONSIDERATIONS

Numerous opinions and proposals have been advanced by different groups and individuals regarding the extent to which the property tax should be relied upon in the financing of the local government sector, which services should be financed from the property tax, which local governments should have access to the property tax base, conditions or limitations on the degree of access to the property tax base, and alternative revenues that could be used as either supplements to or replacements for the property tax. In some cases, specific considerations and explicit lines of reasoning have been used in the advancement of particular options. In other instances, options have been identified with relatively little information or analysis which would be useful in their evaluation.

The Commission believes that sound analysis requires that options be discussed and evaluated on the basis of criteria or considerations. The Commission has listed the considerations identified by those making submissions and has developed others. In turn, these considerations have been analyzed to determine their validity or their usefulness in examining the options. Finally, the Commission has derived some conclusions from an analysis of the considerations.

The Commission recognizes that different degrees of emphasis can be placed on each of the considerations and that this can influence the ultimate conclusion which is reached.

The Commission has discussed 18 different considerations which have been identified. These considerations fall into three main groups:

- **Equity and Fairness** - includes those considerations which relate to the fairness or equity of different forms of taxation and the degree to which different taxes are relied upon.
- **Administration and Governance** - includes those considerations which relate to the nature, needs and rights of local governments, as well as administration and financial considerations.
- **Provincial Economic Interests** - includes those considerations which relate to the economic interests of the province.

The considerations do not all point to the same conclusion. In fact, a number of them are in conflict with one another. To assist in the analysis, each of the considerations is discussed separately and the directions suggested by that particular consideration are identified. After all of the considerations are discussed, their relative importance are assessed and some conclusions are drawn.

It should be noted that in the view of the Commission, those considerations which point to the need for a local source of revenue in effect point to the need for access to the property tax. As pointed out in Chapter II, the Commission has concluded that there is no desirable and feasible replacement for the property tax. The appropriate level of property taxation relative to other forms of taxation is, however, a separate question.

1. EQUITY AND FAIRNESS

The utilization of the property tax base is analyzed in this section from the standpoint of a number of considerations that relate to equity and fairness.

A. Relative Equity of Different Forms of Taxation

Each form of taxation has its own merits and drawbacks in terms of fairness or equity. No one tax is by any means perfect.

1) Personal Income Tax

The personal income tax is based on the assumption that ability to pay taxes is related closely to the amount of income earned. Most people regard the income tax as being the most fair form of taxation, because the larger the income, the larger the amount that is assumed to be available to pay the tax.

There are, however, a number of problems with the tax, some of which are:

- Some people with high incomes are able to arrange their financial affairs so that they have little or no taxable income. Thus, although the tax rates are progressive, the net effect of the tax can be regressive.
- There is a growing "underground" or "barter" economy in which a considerable amount of income is unrecorded and untaxed.
- The tax may act as a disincentive for those who wish to increase their incomes.

There are other issues in connection with the income tax which may or may not be classified as problems depending on one's point of view. For example:

- Interest on monies borrowed to acquire business assets can be used as a deduction from taxable income, thereby assisting in the accumulation of assets, with subsequent capital gains being taxed at lower rates than other forms of income.
- The personal income tax could be regarded as discriminatory against the family which has a single earner of income. Income tax is calculated on the basis of the income of the individual and, as a consequence, the tax load on a family unit differs depending upon the number of income-earners in the family. For example, a family of four with a total income of $40,000 earned by one member of the family pays 25% more in income taxes than a similar family which has two incomes of $15,000 and $25,000.

2) Flat Tax or Tax on Basic Income

Proponents of a flat tax concept may have one or all of three major objectives:

- The reduction of what they consider to be excessively high marginal rates of taxation under existing progressive rates of income taxation. In other words, the concern is that when middle or higher income-earners generate additional income, too much of that additional income is lost to taxation.Some question the fairness of high marginal rates of taxation. Others argue that high marginal rates of taxation act as a disincentive for saving, investment and business risk-taking, thereby impairing economic growth.*
- The elimination of many deductions from income which are available under the present income tax system and which allow many on high incomes to pay little or no income tax.
- The reduction of the complexity of the tax system.

From the foregoing, it follows that there are numerous flat tax concepts, depending upon which particular objective or objectives are emphasized.

By limiting the number of deductions allowed in calculating the amount of income subject to taxation, a flat tax does make it more difficult for those on higher incomes to reduce or eliminate the payment of income taxes. A flat tax rate also provides less disincentive to save, invest, and improve income. Fewer deductions and simplified calculations reduce complexity and enhance comprehension of the tax system but may also create inequities. For example, it would seem unfair for a person with several dependents to pay the same income tax as a person with the same income and no dependents.

The "underground" or "barter" economy creates the same problems for the flat tax or the tax on basic income as it does for the personal income tax. Depending on what deductions from income are allowed and the level of income at which income becomes taxable, the tax may or may not be regarded as being fair. Many would argue that regardless of changes in deductions, it is unfair to tax low and high incomes at the same (i.e. flat) rate, and that equity can be achieved only when higher rates are levied on higher incomes than on lower incomes.

3) Sales or Consumption Tax

The sales tax is based on the assumption that ability to pay is reflected by the amount of spending or consumption done by a person.

The main problem with this tax from the standpoint of equity is that people with low incomes tend to allocate more of their incomes to necessities which could be subject to a sales tax than do people with high incomes.

This problem is often offset to a considerable extent by exemptions for certain items such as foodstuffs. That portion of income which is allocated to savings or investments is not subject to a sales tax. This means that persons with higher incomes, who are able to allocate more of their incomes to savings or investments, pay less sales tax in proportion to their incomes than do people on lower incomes. This is a characteristic of a regressive tax.

4) Property Tax

The property tax is based on the general assumption that wealth is a measure of ability to pay.

While it is true that wealth is one measure of ability to pay, there are several problems with the property tax as a measure of wealth. For example:

- The tax base includes only real property assets.Comparing persons with equal total wealth, those who hold a higher proportion of their assets in the form of real property pay more in property taxes relative to those who hold their assets in other forms. This situation applies whether the real property assets are

* See "Appendix B" for an outline of average and marginal tax rates.

consumable (i.e. housing), or income-producing such as farmland or commercial land and improvements.

- Those who earn their incomes or accumulate wealth, in large measure through real property assets, pay more in property taxes than persons whose incomes are earned only in small measure through real property assets, even though their total wealth or incomes are the same.
- It does not take into account the amount of equity the owner has in the property. A person who owns his property outright pays no more tax than a person who has outstanding loans covering a high proportion of the value of the asset.
- While the value of residential property may be a general reflection of ability to pay, it is by no means a perfect reflection. Factors other than the amount of wealth or income also influence the choice of a home.
- It is insensitive to variations in income, cash flow or liquidity from year to year.

Two significant advantages of the property tax from the standpoint of equity are that it is a difficult if not impossible tax to evade, and that non-resident property owners are required to pay the tax.

There are several ways in which property assessments in Saskatchewan are related to income or potential income:

- Parcels of agricultural land are valued in relation to one another in a way which is intended to reflect the relative ability of those parcels of land to generate net income over time.
- In the case of commercial land, location, size, zoning, etc., are market factors which determine the income-earning potential of a site. These same factors are also considered in valuing land for assessment and tax purposes.
- Business assessments in Saskatoon are based on rental values which reflect the income-earning potential of particular locations, because a better location can command a higher rent in the rental market.*
- There is a correlation between income and the value of the home which is occupied, even though that correlation is by no means perfect. People with high incomes tend to live in larger, more expensive homes, while people with low incomes tend to live in smaller, less expensive homes.

The Commission notes that, in terms of equity, all the above-noted taxes have their strengths and weaknesses. It is not practical for governments to choose the best tax and rely exclusively on that one tax. Other considerations discussed in this chapter will assist in arriving at conclusions on the extent to which property taxes should be relied upon relative to other taxes.

B. Trends in Utilization of the Property Tax

In its first *Interim Report,* the Commission noted the trends in the degree of reliance on property taxes and on income taxes as a percentage of Saskatchewan's Gross Domestic Provincial Product (G.D.P.P.).* Property taxes have fallen from 4.88% of G.D.P.P. in 1968 to 3.16% in 1982, a decrease of 35%. Personal income taxes have increased from 6.93% of G.D.P.P. in 1968 to 9.80% in 1982, an increase of 41%. While both personal income and property taxes have increased in absolute terms, income taxes, as a relative proportion of the province's total income, have increased considerably.The 35% decrease in reliance on the property tax in Saskatchewan compares with a 27% decrease for Canada as a whole. The 41% increase in reliance on income taxes in Saskatchewan also exceeds the national average increase of 38%.

The preceding discussion on the relative equity of different forms of taxation might be regarded as suggesting that more reliance should be placed on income taxes, particularly if the income tax system is reformed, and less on property tax. However, the Commission believes the shift that has already been made from the property tax to the income tax, needs to be taken into account in evaluating this matter.

C. Benefit and Ability to Pay Principles

There are two main principles or philosophies which underlie the financing of public services:

- Equity and fairness occur when people pay for public services in proportion to the benefit they receive from those particular services.
- Equity and fairness occur when people pay for public services in relation to their ability to pay.

Both principles are used currently, often concurrently. For example, natural gas, electricity, domestic water supply, and urban transit are financed on the basis of the benefit

* Business assessments used elsewhere in Saskatchewan also represent an effort to reflect the rates of return to different types of business. See *Property Assessment in Saskatchewan,* a separate report issued by the Commission, for an evaluation of this system.

* See pages 35 and 36 of the January, 1985 *Interim Report.*

principle to the extent that user charges cover the cost of those utilities. A gasoline tax used for road construction and maintenance might be regarded as a tax based on the benefit principle in that the more the streets or roads are used, the more gasoline is purchased and the more taxes are paid. For most government services, however, there is no attempt to trace the beneficiaries of services, nor is there an endeavour to collect taxes in proportion to those benefits. Instead, taxes based on various measures of ability to pay (income, wealth, consumption expenditures) are used to finance most services.

Some suggest that the benefit principle should be used to determine the extent to which the property tax should be utilized. Specifically, it is suggested that local services can be divided into two categories–those which are "services to property" and those which are "services to people"– and that, in accordance with the benefit principle, the property tax should be used only to finance "services to property". It is further suggested that "services to people" such as education or health should be financed by other taxes such as the income tax, and that on the basis of the foregoing criteria, only municipalities should use the property tax.

The Commission has the following observations regarding the combined notions of the benefit principle and the distinction between "services to people" and "services to property":

1) The distinction which some endeavour to make between "services to people" and "services to property" is misleading because, ultimately, all services are intended to be "services to people". The Commission is unable to identify any government service at any level of government which is not intended to be a benefit to people.

   Some government services are intended to provide a benefit to all people within the community. The provision of a safe and clean supply of drinking water, for example, is a service which benefits all people throughout a community. Other services, on the other hand, are intended to be a benefit to a particular group of people. The provision of a specially equipped bus for handicapped persons is an example of the latter type of service.

   Some services provide benefits to people associated with property, either as owners, or renters. Fire protection, for example, is a benefit to people who own or rent property that is subject to loss or damage from fire. Those services which are sometimes classified as "services to property" are more properly classified as services to a particular group of people.

   A better term to describe such services might be "property-related" services.

2) The services provided by municipalities cannot be clearly classified as being "property-related". Accordingly, the suggestion that municipalities should have the exclusive right to tax property because they provide "services to property" has little foundation.

   The Commission considered the main services provided by municipalities. Some examples of the Commission's observations in regard to those services are as follows:

   - Police Protection - Without trying to classify all aspects of police services, the Commission notes that police provide protection for people against assault and other such criminal activity. They also prevent theft of or damage to property. Most of the protection of property, however, is for personal property that does not form part of the property tax base. It would appear that one-third or less of police services are associated with property which is subject to the property tax.
   - Fire Protection - Fire departments provide protection for structures that form part of the property tax base. They also protect the non-taxable contents of structures and the people who live, work or do business in those structures. At least one-third of the fire protection services is a benefit to people or things that are not part of the property tax base.
   - Health Services, Social Services, Recreation Services, Cultural Services, Library Services - None of these services are "property-related".
   - Rural Roads - A substantial part of rural road services are "property-related" because of the provision of access to the land for farm machinery and equipment, the provision of a means by which fuel and fertilizers and other necessities for farming operations are brought to the farm, and the provision of a means by which products of the land can be delivered to market.

     Another major part of rural road services provide benefits that are not related to the rental or ownership of property. Rural roads provide a means of transportation to gain access to educational services, shopping, medical services, recreation, postal services and general travel. At least one-third and possibly as high as one-

half of the rural road services might be classified as being non "property-related".*

- Urban streets and roads - While urban streets and roads provide a benefit to the abutting owner or renter of property, the greatest beneficiaries are people in the general community who utilize the overall system of streets and roads.
- Garbage collection and disposal - While a distinct benefit from this service is provided to owners or renters of property, it would seem that at least one-half or more of the benefit of cleanliness and disease prevention accrues to the community as a whole, rather than to people as owners or renters of property.

The Commission identified a number of major municipal services such as health services, social services, recreation and cultural services, and library services which clearly fall outside the category of "property-related" services. On the other hand, the Commission was unable to identify any major municipal services which were clearly and exclusively "property-related". A number of services fall to varying extents in both categories. Overall, more expenditures on municipal services appear to fall into the category of services to the community as a whole, or services which are unrelated to the nature or amount of property owned or rented, rather than in the category of "property-related" services, particularly in urban municipalities.

The purpose of the foregoing is not to arrive at a precise percentage of municipal services which fall into each category. There is too much subjectivity involved to arrive confidently at such a percentage. Rather, the analysis is intended to illustrate that two arguments:

- that municipalities should be the exclusive users of property tax because they provide "services to property", and
- that school divisions should not have access to the property tax because they provide "services to people",

are not valid considering the substantial amount of services provided by municipalities which do not relate to the ownership or rental of property.

3) Whether or not a particular service may be regarded as providing a benefit to people in general or to owners or renters of property, property taxes are not levied in a manner which is at all closely related to the level of benefits from services enjoyed by renters and owners of property. For example, older inner-city neighbourhoods might account for a higher proportion of costs of police enforcement and fire fighting, yet the newer, more highly assessed neighbourhoods are assessed and taxed for these and other services at a higher level than older neighbourhoods. It costs no more to collect garbage from a new, more highly assessed neighbourhood, yet a new neighbourhood is assessed and taxed at a higher level than an older more run-down area of a city. Rural roads provide as much benefit to a farmer located on average land as to a farmer located on highly assessed land, yet the latter farmer pays more in property tax.

There is a major inconsistency in the argument that the property tax should be used to pay for services to property (the benefit principle) considering that the property tax does not generate revenues in proportion to the services provided. The very essence of the benefit principle is that taxation should be used to finance services in proportion to the benefits received from those services. In short, the property tax seems to reflect the ability to pay principle rather than the benefit principle. The property tax is not designed to yield, nor does it in fact yield, revenues which are proportional to the services provided to the owners or renters of properties to which the property tax is applied. Instead, the property tax is designed, however imperfect this effort may be, to yield tax revenues proportional to the ability to pay of the owner or renter of the property.

The conceptual and practical difficulty of designating services as either "services to people" or "services to property", taken together with the apparent fact that the property tax is not based on the benefit principle, suggests that the benefit principle and the services to people/property distinction are not helpful in coming to conclusions on the extent to which the property tax should be relied upon, or which local governments should have access to the property tax.

* Some might argue that all rural transportation services are "property-related" because if the property (farmland) were not located there, there would be no people there and no need for services in those locations. Using this line of reasoning, however, services such as education and health would also have to be deemed "property-related" because without the farmland, people would not be living there and there would be no need for education or health services in those areas either.

D. Revenues Based on Benefit Principle

Although the current property tax is not designed to generate revenues proportional to the usage of local government services, the question arises as to whether greater equity would be produced if less reliance were placed on the present property tax and more reliance were placed on methods of raising revenues that were more closely related to the level of benefits received by the individual owner or renter of property.

There are three possibilities in this regard:

- First, some taxes might be collected from property owners in ways which may more closely correlate with the level of benefit received by the occupant of the property for particular services. This approach might be used to finance that portion of certain services which are deemed to provide benefits to individuals by virtue of their ownership or rental of property as opposed to individuals in general or the community at large. The traditional property tax could continue to finance those services or those portions of services which provide benefits to the community in general.
- Second, user charges could be increased for certain services.
- Third, another form of taxation for which there is a closer correlation between the amount of tax revenue and the benefits received by the taxpayer might be utilized.

1) Physical Measures of Property

The Commission tried to determine whether some simple **physical** measures of property such as front footage or square footage for land, or square footage or cubic footage for buildings could provide a basis of taxation which would provide a closer correlation between levels of taxation and benefits from those services which are partly related to property. In other words, the Commission examined the potential of **physical** as opposed to **value** measurements of property as a base for taxation.*

A physical basis for raising revenue from property owners is not a new concept. Some services such as streets and sidewalks are considered to provide a partial benefit to the community as a whole and a partial benefit to the occupant of the abutting property. Part of the cost of such projects may be financed by a frontage levy or local improvement charge. The question is whether or not more local government services, for capital or operating purposes might be financed on a similar basis.

The Commission examined the possible use of physical measures of property to be used in determining a tax base to finance the following services:

i) Police Services

Part of police protection is the protection of property, specifically buildings. It could be argued that it is mainly the ground floor, rather than any additional stories above the ground floor that primarily require police protection and that, consequently, a levy based on the building's square footage should be made to cover part of the costs of police protection.

ii) Fire Protection

It could be argued that the amount of benefit buildings receive from fire protection is related to the cubic footage of buildings and that, consequently, a charge based on cubic footage might be levied to cover part of the costs of fire protection.

iii) Garbage Collection

A standard levy per residence could be made, possibly with a lower rate for multiple family units where fewer stops are required. This is already being done in some communities.

iv) Residential Street and Sidewalk Maintenance

An ongoing levy for maintenance and snow clearing based on front footage might be used to pay for that portion of residential streets deemed to benefit the person occupying the adjacent properties.

v) Rural Roads

Rural roads might be financed through a variety of physical measures, either individually or in combination:

- A flat rate per farmstead to reflect the benefit of having access to roads for general family purposes.
- A flat rate based on mileage of property abutting roads, to reflect the benefit of access to the farmland.
- Various flat rates per farmstead, depending on the type of operation. For example, one rate could be set for dairy farms, reflecting the fact that frequent usage of roads for raw milk pick-up is necessary, while another rate could be set for grain farms which require less frequent access.

* S.A.R.M. suggested exploration of a concept along this general line in its brief to the Local Government Finance Conference in September of 1984.

vi) Maintenance of Sewer and Water Lines

A frontage levy for local lines could be used to supplement rates based on consumption.

On balance, the Commission opposes the greater use of physical measures of property as a tax base, for the following reasons:

- Decisions on which measures of property to use and how much of the costs of each service to finance on that basis would be largely arbitrary.
- Administrative complexity of the property tax would be increased.
- Ratepayers would find the property tax system difficult to understand because of the use of both physical and value measures of property.
- In circumstances where it is difficult to trace the benefits or the degree of usage of services to individuals, equity and the perception of equity is more likely served by raising revenues on the basis of ability to pay.

2) User Charges

There are opportunities for greater use of user charges and less reliance on property taxes, particularly in urban municipalities, if this were considered desirable. For example:

- Communities incurring operating deficits in their water, sewer or transportation utilities could eliminate the deficits by increasing user charges, thereby reducing the extent to which the general property tax must supplement those operations.
- Communities which use all or a portion of their unconditional provincial capital grant for utilities such as sewer and water could use those grants for other municipal purposes, thereby reducing the reliance on the property tax to finance those other services. The capital cost of utilities could be financed to a greater extent from debentures which could, in turn, be retired through the appropriate level of user charges.
- More communities could finance some or all of the cost of garbage collection through a schedule of fees.

3) Other Taxes Based on Benefits

A provincial tax on gasoline could be used to finance transfers to local governments, either as grants or revenue sharing payments, for use in funding the transportation infrastructure. In rural areas, changes in grain delivery are placing great demands on roads and substantial sums of money will be required to upgrade many roads. Urban communities also have ongoing transportation needs. A gasoline tax can be regarded as a user charge in that the greater the usage of streets and roads, the greater the amount of gasoline which must be used and the greater the amount of taxation which must be paid.

The amount of fuel consumed by a vehicle correlates closely with the usage of the transportation system. The Commission is of the opinion that equity can be served by placing more of the responsibility for financing the transportation infrastructure on the users of the system and less on the property owner.

4) Criteria for User Charges

The Commission is of the belief that equity could be improved if there were **some** shift to revenues raised on the benefit principle. The question of the extent to which revenues should be raised in accordance with the benefit principle as opposed to the ability to pay principle is highly subjective, but the Commission believes that the following criteria would be helpful:

- User charges should be used only where the amount of use of the service can be reasonably and readily quantified.
- User charges are appropriate for financing services for which conservation of usage is desired. Water services would be an example.
- The level of user charges should be set carefully in regard to services where the community interest is served by promoting greater usage. For example, cities which operate a transit system will likely set fares at levels which will be high enough to yield significant revenue, but which will not be so high as to substantially discourage use of the system. If fares are set too high, usage of the system will decrease and its overall viability could be jeopardized.
- User charges should not be hidden taxes which are higher than required to finance the service in question, and which are used to finance other general services.

E. Tax Incidence

Tax incidence refers to the distribution of the tax burden of a particular tax or set of taxes among the taxpayers.Each type of tax impacts differently on different categories of taxpayers. If one tax is

increased and another tax is decreased, the overall amount of tax revenue generated within a given area may stay the same, but individuals within the area will end up paying different amounts of taxes.

For example, some taxes generate more revenue from non-residents than other taxes. Some taxes relate to businesses, while other taxes relate to individuals. Some taxes impact more on persons with higher incomes or with wealth in the form of real property than other taxes, and so on.

Tax incidence may or may not be a consideration in arriving at decisions on which type of local government should have access to the property tax. It is possible to bring about a change in regard to which local governments have access to the property tax without making significant changes in the reliance on the property tax relative to other taxes. In this instance, tax incidence has little relevance to the analysis. If a change in access to the property tax is implemented by means of a change in the overall reliance on the property tax relative to other taxes, then the incidence of taxation is changed and it is important to analyze that change in incidence.

Changes in the mix of taxes that are used to finance local governments, both in terms of taxes raised locally and provincial government taxes to finance transfers to local government, obviously have an impact on tax incidence and need to be analyzed from that standpoint as part of an overall evaluation.

F. Rural/Urban Balance

There are concerns about the distribution of tax load when services, such as education or health, are financed partly by common levies on both the urban and rural property tax bases. This appears to be a substantial part of the desire of some people to see these services financed from sources other than the property tax.

Rural representatives have stated that rural per capita property taxes are higher than urban per capita property taxes. In 1981, rural municipalities had only 25.9% of the population, but had 38.7% of the equalized assessment. Equalized assessment per capita in 1981 was $2,331 for urban municipalities and $4,208 for rural municipalities. If both rural and urban property owners were taxed at the same rate, rural property owners would pay 81% more per capita in property taxes than their urban counterparts.

A simple per capita analysis of assessments or taxes paid may provide sufficient basis for determining that a review is needed, but it is not a sufficient basis upon which to draw conclusions. For example, the fact that many farmers reside in an urban community has the effect of overstating the per capita rural taxes paid and understating the per capita urban taxes. Also a significant part of the tax yield in rural municipalities comes from large businesses like oil companies, potash companies, steel mills, etc. The proportion of industrial and commercial property in rural municipalities compared with urban municipalities would have to be examined along with other factors before coming to conclusions.

If it were determined that, over a period of time, the rural sector in general or agricultural property in particular currently pays too much in property taxes relative to others, this does not necessarily mean that education, hospitals, and libraries should be financed from sources other than the property tax. It might suggest that the rural revenue sharing pool should be increased relative to the urban revenue sharing pool. It might also point to the need for an adjustment in the percentage of appraised value of farmland that is used in arriving at assessed value. For example, if farmland were assessed at something less than the 60% of value which was used in the current assessment, the effect would be to place a smaller overall tax load on the rural sector for hospital and school purposes. Decisions on tax incidence matters like this are an important part of a sound system of property taxation.

The Commission notes that one of the important responsibilities of those who govern the assessment function is to consider the various balances in property taxation, and that although the rural/urban balance is very important, it is by no means the only balance to be considered. For example, within an urban community, the appropriate division of the tax load between the residential and commercial sector must also be addressed.

The Commission has come to no conclusions on the appropriateness of the current distribution of the tax load between urban and rural property owners, but is of the opinion that a study needs to be done on this area.

2. ADMINISTRATION AND GOVERNANCE

The utilization of the property tax base is analyzed in this section from the standpoint of a number of considerations that relate to administration and governance.

A. Autonomy

In its January, 1985 *Interim Report*, the Commission devoted considerable attention to the concept of autonomy for local governments.*

> "Each of our communities has a distinct character. Each community has a different set of views in relation to the type of services which are desired, priorities among different

* See pages 24 to 30 and 33 to 34 of the January, 1985 *Interim Report* for a detailed treatment of this topic.

types of services, the level of taxation which is considered reasonable to support those services, and the kind and extent of local laws that should govern its citizens. It is the existence of these inter-community differences that forms one of the primary purposes of having local government. If individual local governments have the ability to make their own decisions, there is a far greater opportunity to meet the needs and desires of each community than would be the case if the provincial government were to make those decisions. The Commission strongly subscribes to the philosophy that wherever possible, local people should be allowed to direct their own affairs through a strong and independent local government structure . . ."

"If particular local desires are to be reflected, local governments must have the independence or autonomy to make their own decisions and for those decisions on types and levels of services to vary from community to community. In turn, this means that provincial legislation creating local governments must provide sufficient local discretionary powers. Provincial grants should be largely unconditional so as to impinge as little as possible on the effective choices available to local governments. Most importantly, those local governments must have access to a meaningful source of local revenues . . ."

"Access to a local source of revenue is critical to the autonomy of local governments. Local governments having no access to local sources of revenue and being completely reliant on provincial funding may have considerable latitude for local decision-making if they receive their grants unconditionally. That is, they may have considerable autonomy to make decisions on priorities within the level of spending determined by the Province. However, they are not autonomous in regard to the **level** of total expenditures. Residents of some areas of the Province may desire a higher overall level of services than other areas of the Province and may be prepared to pay the additional local cost involved. Without a local source of revenue, the power to determine overall levels of services is in the exclusive hands of the provincial government and there is no local autonomy in this particular regard . . ."

The Commission analyzed and evaluated several alternative local sources of revenue in Chapter II and concluded that there was no practical and desirable alternative local revenue that could replace the property tax. This, combined with the need for a local revenue source to meet the requirements of autonomy, suggests that local governments continue to have access to the property tax for a portion part of their revenue.

B. Types of Locally Delivered Services

The previous section on autonomy dealt with the notion of autonomy as a principle in somewhat general terms. The question arises as to whether local autonomy is required for all types of locally delivered services, whether there can or should be different degrees or types of autonomy for all types of services, and whether a local source of revenue is required for all types of local services.

Provincial legislation provides for the delivery of some services at the local level either by what may be considered local governments or by other agencies or boards which function at the local level. Responsibility for services may be assigned to the local level because it is thought to be more efficiently administered locally or because it is considered appropriate for decisions on the level of services to be made locally, or both.

There are three main types of services which are delivered at the local level:

1) Services which are purely local in nature. These are services for which the local authorities decide:
   - whether the service is provided at all within the community;
   - the level or extent of the service;
   - the standards of the service; and
   - how the service is delivered.

   There are few, if any, provincial regulations governing such services. The provincial government has no overriding interest in the matter and it is deemed appropriate to have all decisions pertaining to those services made at the local level and for the administration to be done at the local level.

   A number of services provided by municipalities fall in this category. Recreation, fire protection, paving urban streets and roads, and the provision of local access roads in rural municipalities are examples. Because all or essentially all of the decisions pertaining to such services are made locally, and no major province-wide interest is at stake, it is logical that the local authorities responsible for making decisions on those services have a local source of revenue with which to implement their decisions.

2) Services for which the provincial government has an interest in enforcing a certain minimum standard, but for which other decisions are deemed to be

appropriate to be made at the local level. Elementary and secondary education is an example of this type of service.

Province-wide standards exist in regard to such matters as the minimum curricular offerings which must be provided, minimum teacher training requirements and the length of the school year, and these standards are set out in statutes and regulations.

Local decisions determine such matters as the number of programs and services to be provided above the required minimum, numbers of staff employed and class sizes, the levels of training and experience of teachers they hire, and the level of other resources applied to the delivery of the programs. All such decisions determine the level of expenditures for the school divisions and, because local desires in regard to these matters vary from school division to school division, there are corresponding variations in the level of expenditure. It is also logical for authorities responsible for delivering such services to have access to a local source of revenue so they are able to finance these variations in local expenditure level. It would be unreasonable and would defy any principle of accountability for the Province to "write a blank cheque" and simply agree to fund whatever local decisions are made on expenditure levels. Therefore, if it is desirable for local decisions to be made on levels of services and expenditure, it follows that the authorities responsible for making those decisions should have access to a local source of revenue to make it possible to implement those decisions. The minimum requirement would be for access to local revenues of sufficient magnitude to cover at least that portion of overall expenditures that could be classified as discretionary.

3) Services for which the provincial government sets the standards and level of services, but for which administration is thought to be more effectively done at the local level. For services in this category, there may or may not be much local flexibility for setting priorities within the determined level of expenditure. The key characteristic is that the expenditure level is determined entirely by the provincial government, not by the local authorities. An example of this type of service would be the Home Care Program.

   Delivery of this category of service is delegated to local authorities because it is thought to be administered more effectively at that level either because of the advantage of smaller scale operations, the need for local circumstances to be taken into account, or other factors which may make it less suitable or efficient to have administration carried out by provincial authorities.

   It could be argued that accountability to the local people being served might be enhanced by having a local source of revenue to cover part of the cost of such services, but such an argument is not compelling because the major policy decisions on the nature and level of services are made by the provincial authorities, and a major part of the accountability is to those provincial authorities. In short, there is no particular need for a local source of revenue for such services because the service level and expenditure level is not determined at the local level.

In a subsequent report the Commission may wish to examine certain provincial services to see if it would be more appropriate to have them delivered at the local level and, correspondingly, to see if there may be some local services for which responsibility for administration and funding should be given to the provincial level. However, it is clear to the Commission that the bulk of services provided by municipalities and school divisions fall into either the first or second categories as outlined above, and that a local source of revenue is very important for the local authorities delivering those services.

With particular regard to education, for which the greatest number of comments have been made regarding financing, the Commission believes that people in Saskatchewan want to participate in decisions regarding the level and nature of services provided in their local schools. They may not all be satisfied with the degree of influence they now have on those decisions, but it is clear that they have a greater role now than they would if there were complete provincial funding of education. Complete provincial funding of education would remove the ability of the local people, through their elected representatives, to make decisions on levels of services that may differ in their respective communities. There has been a long history of local participation in education decision-making in this province, and the Commission believes that it should be continued.

The nature of elementary and secondary education and most services delivered by municipalities is such that a local source of revenue is required for at least part of the financing of those services.

C. Other Needs of Local Government

Local governments also require equalization payments from the provincial government. This need arises because the wealth of local governments or the size of their local tax bases varies considerably and, as a result, there are corresponding variations in the ability of local governments to raise revenues and provide services.

Provincial grants or revenue sharing payments must compensate for these variations in local fiscal capacity in order to ensure that residents throughout Saskatchewan have access to basic levels of service without resort to unduly high local tax rates. Under a system of provincial equalization payments, some local governments get little or no grants because their own local tax base is sufficient to meet local needs. Other local governments with a very limited local tax base require very substantial grants in order to provide comparable levels of service at similar local tax rates.

In order for equalization payments to achieve their objective given the current disparities in local fiscal capacity, they must constitute a reasonably sizeable portion of overall local government revenue. From the standpoint of the need for equalization, there are limits on the extent to which local revenue sources can take the place of provincial revenue sources.

Local governments also need relatively stable revenue sources. Unlike their federal and provincial counterparts, local governments are not in a position to finance a major part of their current operations by borrowing if revenues fall or if they grow more slowly than expenditure requirements in a particular year or years. The property tax is relatively stable, compared to taxes based on income or sales which are more sensitive to upswings or downturns in the economy. Hence, taxes based on income or sales tend not to meet this particular need of local government as well as the property tax.

D. Accountability to the Taxpayer

Local governments are accountable electorally and in other ways to local citizens for the quantity and quality of services they provide. When local governments finance part of the cost of their services from a local tax, it provides a basis of interaction or contact between the local government and those who are served by that local government. As a result, accountability for use of public funds is promoted. One urban representative concurred with this thought by stating that in his opinion, "the best spent dollar is a dollar which is raised locally". The desirability of accountability, together with the requirements for autonomy, support the need for a local source of revenue.

E. Limits on Use of the Property Tax

Some have suggested that it might be acceptable to have particular services financed from the property tax, provided that specific limits were placed on the extent to which the property tax could be used.

One way of putting a limit on usage of the property tax would be to require the provincial government to finance a minimum percentage of the expenditures of a local government. Unless the provincial government were to enforce other means of controlling local government expenditures, the local government would be free to continue to make independent decisions on the level of expenditures and the provincial government would be obliged to finance a pre-determined percentage of those costs, regardless of its own fiscal circumstances and its view about the desirability of the levels of expenditures decided upon by the local governments.

The opposite approach to putting limits on the use of the property tax would be to enforce a specified maximum percentage of costs which local governments would be permitted to finance from local tax sources. In this situation, local governments would, in effect, have their expenditures controlled by the Province. Local government spending could not exceed the percentage change in government grants without the local share exceeding the pre-determined specified percentage.

The respective percentages of costs borne provincially and locally vary from local government to local government because of equalization in provincial grants. If individual percentage limits were set for each local government the process would be arbitrary and contentious. If an overall average percentage were used, there would be no means of controlling what was done by the individual local governments. This suggests that it would not be practical to restrict local government taxation through a specific percentage limit on local shares of costs, even if it were deemed to be otherwise desirable.

Alternatives to limits on the percentage of expenditures financed from the property tax would be limits on the number of mills which could be levied, limits on the per capita spending of a local government, or limits on the percentage by which their expenditures might increase in a particular year. From a technical standpoint, such measures would be more feasible than placing percentage limits on the local share of costs.

Regardless of their technical and administrative feasibility, all of the foregoing measures which endeavour to put a precise limit on the use of the local tax base, conflict fundamentally with local autonomy, a basic underpinning of strong local government.

The establishment of general targets in terms of the extent to which the property tax is relied upon, is a different matter. The provincial government could establish a percentage of costs of local government which it believes should be financed by the provincial government and the appropriate level of transfer payments to the local governments could be made. In any given year, the provincial government's share of costs may be higher or lower than the target, depending upon differences between the spending decisions of the local governments and the funding decisions of the provincial government. As long as those decisions can be made independently and as long as it is recognized that there is no specific target or limit to enforce, the autonomy of both the provincial government and the local governments can be maintained.

F. Complexity: Multiple Taxing Authorities

The property tax is currently used in part to finance municipal, school, hospital and library services. It has been suggested that issues surrounding assessment and property taxation would be less complex and more readily resolved if only municipal governments used the property tax. For example, it is suggested that:

- If no taxing authority were involved in simultaneously taxing both rural and urban property for the same service, there would be no need to be concerned about the respective amounts raised from rural as opposed to urban property owners, or how to design an assessment system which would produce the desired rural/urban balance. Questions of rural/urban balance in tax loads would relate mainly to the question of the appropriate size of the urban and rural revenue sharing pools.
- Equalization of assessments would not be as crucial.Equalized assessments would be used only for analytical purposes and in the calculations of revenue sharing payments within separate urban and rural revenue sharing pools. Equalized assessments would not be used in the distribution of tax loads among a mixture of urban and rural property owners as is presently the case with the calculation of provincial grants to school divisions, or the levying of taxes by school divisions.
- Municipalities, schools, hospitals and libraries each currently make independent decisions involving judgments about the amount of local services required and the ability or willingness of the local taxpayer to pay for those services, without necessarily knowing what the other bodies have decided in this same respect. Collective decisions can, consequently, end up being inappropriate. Inappropriate decisions on the level of local taxation would be less likely if only one local body were making those decisions.
- Issues surrounding the governance of the assessment function would tend to be somewhat less complex, because there would be less need to develop comparable or compatible urban and rural assessment systems.Rural government could concentrate on developing and maintaining an assessment system suitable for rural municipalities without having to understand or be concerned about urban assessments and, likewise, with urban governments.

The Commission recognizes that some issues would become less complex or more readily resolved if the numbers of local governments having access to the property tax base were reduced or if the use of the property tax was restricted to one type of local government.

The Commission has also considered a significant number of other specific assessment issues and concerns ranging from the treatment of downtown versus highway commercial property to the weighting of land versus improvements in calculating overall assessments. It concluded that the removal of education or other common services currently financed by the property tax would resolve very few of these issues. These issues may be less acute if, in the process of removing such services from the property tax, the overall level of property tax is reduced, but the issues would continue to be issues requiring attention.

G. Amenability to Changes in Expenditure Levels

Some have suggested that year-to-year variations in the collective ability to pay of property owners within a particular local government unit could be taken into account by the local government. In a year when the collective ability to pay has declined, the local government could decide to spend less on its services and lower taxes. In a subsequent year or years, when the collective ability to pay has improved, the local government may decide to restore previous spending and tax levels or have higher spending and tax levels to provide a "catch-up".

Some have suggested that it is more practical or feasible to make substantial year-to-year variations in spending levels for certain services than it is for other services. They have suggested that the property tax should be used to finance those locally delivered services which are amenable to substantial year-to-year variations in expenditure levels, while broader provincial sources of revenue should be used to finance locally delivered services which are not so amenable to major expenditure variations. In this way, it is argued, the level of the property tax can be more closely related to the collective ability to pay of property owners within a local government jurisdiction in a given year.

It could be argued that municipalities, particularly rural municipalities, have more opportunity to adjust expenditure levels in response to changes in the ability to pay of their ratepayers as a whole than do urban municipalities and schools. Road construction and maintenance make up a large percentage of rural municipal expenditures and it might be argued that it is more practical to have major year-to-year variations in such services than other municipal services or school services. This could be used as an argument for having municipalities funded from the property tax and schools funded from provincial sources.

The foregoing arguments are based on the interests of the public as taxpayers. From the standpoint of the interests of the public as recipients of public services, it could be argued that because school divisions require greater stability in revenues and expenditures, they should have access to a stable source of revenue such as the property tax.

The Commission notes that all local governments provide services which the public considers to be important and it is a highly subjective matter to speculate on which type of local government has the greatest flexibility in making adjustments to the level of spending on those services. There are financial, administrative and political limitations on the amount of flexibility which any type of local government can realistically make in its expenditures. This may be one of the major reasons why it is not uncommon for local governments to hold the line on their tax levels while it is relatively rare for them to actually reduce their tax levels.In short, the relative flexibility of different types of local government to adjust their expenditure levels is a legitimate consideration, but it is not a particularly compelling basis for arriving at conclusions on the fundamental issue of which local governments should utilize the local property tax.

H. Constitutional Considerations

In a recent decision on a case between the Province of Quebec and the Greater Hull School Board, the Supreme Court of Canada ruled that the Constitution had guaranteed rights of separate schools to levy property taxes and that provincial legislation had prejudicially affected those rights. Accordingly, the provincial legislation was struck down.

Chapters 29 and 30 of the Ordinances of the Northwest Territories, 1901, contain several sections outlining the taxing powers and procedures for school boards and there is little doubt that it is the property tax to which the sections refer. Section 17 of *The Saskatchewan Act*, under which Saskatchewan became a province of Canada, contains provisions guaranteeing that no laws could be passed which prejudicially affect rights granted to separate schools under Chapters 29 and 30 of those Ordinances. Section 29 of the *Canadian Charter of Rights and Freedoms* says "Nothing in this Charter abrogates or derogates from any rights or privileges guaranteed by or under the Constitution of Canada in respect of denominational, separate or dissentient schools." Under the *Constitution Act, 1982, The Saskatchewan Act* is part of the Constitution.

Accordingly, it seems reasonably clear that the provincial legislature does not have the authority to remove the right of access to the property tax base for separate school divisions. Public school boards do not enjoy the same protection as there is no constitutional impediment for the provincial legislature to disallow access by those boards to the property tax base. However, it would be inappropriate and discriminatory to abolish the right for one type of school board, while retaining it for the other.

What is not so clear is the extent of restrictions, if any, that the provincial legislature could legally place on the use of the property tax by school divisions, while still retaining their basic right of access.

I. Administrative Feasibility

Chapter II provided an analysis of possible alternative local sources of revenue. It would be technically feasible and administratively practical to raise existing provincial taxes or to implement

certain new provincial taxes if more provincial funds were to be transferred to local governments. These funds, in the form of grants or revenue sharing transfers, could be used to reduce the degree of reliance on property taxes if that were desirable. Increasing the rates for personal and corporate income tax or sales tax, implementation of a gasoline tax, or implementation of a flat tax or tax on basic income would fall in this category.

For locally determined and administered taxes, it would be technically feasible and administratively practical to expand the amusement tax and to implement a hotel occupancy tax. However, these taxes would yield relatively small amounts and could be used only as minor supplements to the property tax, but not as replacements for it.

While it would be possible from a technical point of view to establish a local tax on basic income, income or sales, with rates set by individual local governments and the administration done provincially, the administrative complexities would be so substantial and the costs involved in such options would be so large as to make the options unattractive. Another factor to consider is that these taxes are volatile and reliance on these sources would make fiscal planning for local governments much more difficult.

3. PROVINCIAL ECONOMIC INTERESTS

In this section, the utilization of the property tax is analyzed from the standpoint of provincial economic interests.

A. Inflows/Outflows of Monies from Saskatchewan

Property taxes are allowed as deductions in calculating taxable income for both the corporate and personal income tax for farms and businesses. This has the effect of reducing the amount of income tax that would otherwise be paid. If property taxes were reduced and replaced with other forms of taxation which are not deductible in calculating taxable income, the result would be a decrease in allowable deductions, an increase in taxable income, and the payment of more income tax. Approximately 2/3 of the income taxes collected from Saskatchewan residents are paid to the federal government. It is estimated that for every $100 million by which property taxes might be reduced and replaced with other Saskatchewan taxes, over $15 million in additional income taxes would flow out of the Province to the federal government. Even if 4% (Saskatchewan's share of Canada's population) of these monies flowed back to Saskatchewan by means of increased federal government expenditures, the net loss to the Saskatchewan economy would still be over $14 million.

Non-residents who own property in Saskatchewan pay property taxes to local governments in Saskatchewan. They may or may not pay other types of taxes to Saskatchewan governments.

For example, unincorporated business or individuals from another province who make part of their incomes in Saskatchewan pay no income tax to Saskatchewan.

From the standpoint of this consideration, it would be to the benefit of the Province to maintain or increase reliance on the property tax so as to minimize the flow of tax monies out of the province.*

B. Inter-Provincial Comparison of Tax Rates

Tables outlining the yield of one percentage point on various Saskatchewan tax bases and the 1985 rates of taxation for the major taxes in all provinces are set out in Appendix C and Appendix D. From this information, it is possible to determine the impact on Saskatchewan tax rates if different types of provincial taxes were used to reduce the reliance on the property tax by varying amounts, and to compare the resulting tax rates with those in other provinces.

Although tax rates can provide a general comparison of tax levels for one province relative to another, caution must be exercised in drawing conclusions from the appendices for the following reasons: First, no attempt is made to address differences in tax structures, such as surtaxes and tax reductions, which can significantly alter the effective tax rate on a tax filer. Second, the comparisons do not consider the base on which the tax is applied. For example, the sales tax base differs substantially from province to province. Third, the comparisons are limited to only the few major taxes and, therefore, do not measure the total impact of the respective overall fiscal regimes on individuals and corporations. For example, no reference is made of the different tax and user charges such as payroll taxes and medical care insurance premiums, which are used by Saskatchewan's neighbouring provinces, but are not used in this province.

The primary Canadian economic competitors of Saskatchewan are Manitoba and Alberta and, to a lesser extent, Ontario and British Columbia, depending upon the particular business or profession. It is with these provinces that comparison of tax rates are most relevant in considering the impact on Saskatchewan's economic

* If the provincial government were to finance a reduction in property tax by means of an increase in another tax which is paid by non-residents, there may or may not be a net outflow of tax monies from the province. Sales taxes, for example, are paid by non-residents in regard to purchases made in Saskatchewan.

competitiveness of different ways of funding local government. Tax rates in the Province of Quebec and the Atlantic provinces are more of an academic and political interest.

In regard to the personal income tax, B.C. and Alberta have substantially lower rates (44.0% and 43.5% of federal basic tax, respectively) than Saskatchewan's 50.5%.* Ontario's rate is somewhat lower, at 48.0%, but Manitoba's rate is higher, at 54.0%. The existence of the flat tax in Saskatchewan means that comparing Saskatchewan's taxes on personal income to the tax on personal income in other provinces becomes more difficult. If the revenues from the 1% flat tax on net income were obtained from the regular income tax, Saskatchewan's rate would have to be higher by 8.5 percentage points of federal basic tax. This would put Saskatchewan's rate at 59.0%, substantially higher than all of our major Canadian economic competitors. Although each province has its own system of tax reductions and surtaxes, etc., which also make comparisons difficult, it is reasonably clear that, at present, Saskatchewan taxes income more heavily than all of the above-noted provinces. Whether, under this circumstance, it would be desirable for the provincial government to place less reliance on the property tax and even more reliance on the personal income tax, is doubtful. To raise another $100 million in personal income tax would require an increase of 8.0 points of federal basic tax or an increase of 1.0% in the flat tax on net income.

In regard to the corporate income tax, Saskatchewan's general rate is 16.0%** and its small business rate is 10.0%. No other province currently levies higher rates, but most are quite close to Saskatchewan. Manitoba levies the same rates as Saskatchewan, while B.C.'s rates are 16% and 8%. Alberta's rates of 11% and 5% are considerably lower than Saskatchewan's rates. Ontario's general rate of 15% is close to Saskatchewan's rate, but small business income is not taxed at all in that province.

The corporate income tax does not generate a great deal of revenue relative to what is generated by the personal income tax and the property tax. The corporate income tax is projected to yield $145 million in 1985-86, compared to $626 million and to $625 million for the personal income tax and the property tax, respectively.

Even if the corporate income tax rates were doubled, and the proceeds used to permit local governments to reduce their reliance on the property tax, it would permit only about a 12% reduction in property tax. This would create rates in Saskatchewan which would be three times as high as the small business rate and over twice as high as the general rate as Alberta, and roughly 50% higher than the rates in the other provinces which are Saskatchewan's economic competitors.This would be clearly undesirable. In short, the corporate income tax cannot be regarded as a practical means for bringing about substantial reductions in the level of taxation on property.

Saskatchewan's 5% retail sales tax is lower than in any other province, except Alberta where there is no sales tax. British Columbia is at 7%, Manitoba is at 6% and Ontario 7%. Looking only at rates in other provinces, there would appear to be an opportunity to increase the sales tax for possible use in reducing the reliance on the property tax. Retail sales taxes are likely to have considerably less impact on business location decisions than personal and corporate income taxes, because it is not a significant factor in economic competitiveness. However, the Commission has two reservations in this regard. One is its cognizance of the perennial difficulties faced by Saskatchewan merchants close to the Alberta border with a 5% differential in sales tax, and the realization that an increase in Saskatchewan's rate would only exacerbate that problem.

The other reservation is in regard to the equity of the sales tax relative to the property tax.* It is the opinion of the Commission that an increase in the general sales tax and a reduction in property taxes would, on balance, introduce greater regressivity into taxation in Saskatchewan.

In an earlier section, the Commission raised the possibility of a provincial gasoline tax which would be a type of user charge for transportation and which would be passed on to municipalities for transportation infrastructure expenditures. All provinces, except Saskatchewan and Alberta, have a tax of approximately 20% of the retail price of gasoline. Gasoline or fuel taxes can have a substantial impact on some industries such as farming and transportation and, for this reason, it is justifiable to look at certain types of exemptions such as former policies of tax-free gasoline in farm trucks. However, on balance, it would appear that a gasoline tax could be implemented without putting Saskatchewan at a disadvantage with most other provinces. Each 1% of the retail price of all diesel and gasoline sold would yield $8.9 million.

Per capita property taxes are very comparable among the five westernmost provinces. Ontario and Saskatchewan are the lowest and are virtually tied at $496 and $497 per capita, respectively, and British

* This is the effective rate of tax for 1985, since the tax rate was reduced to 50.0% starting in July, 1985.

** Although there is a considerable difference in the personal and corporate income tax rates of 50.5% and 16%, respectively, it is important to understand that the tax rates are applied to different measures of the tax base. The provincial personal income tax rate is expressed as a percentage of federal basic tax and not as a percentage of taxable income. Federal basic tax is an amount determined after the federal income tax rate is applied to taxable income. In contrast, the corporate income tax rate is calculated directly on taxable income.

* See p. 10 of this report.

Columbia is the highest at $569 per capita.* These figures do not take into account the effect of property tax rebate programs in the respective provinces.

These facts would suggest that, from the standpoint of economic competitiveness, the overall level of property taxes is not a factor contributing to any particular disadvantage in Saskatchewan, and there would be no compelling argument to see property taxes reduced by raising other taxes.**

C. Personal and Business Initiative

While income taxes are favoured by many people in relation to other types of taxes for reasons of equity, there are concerns about the impact this tax can have on individual initiative.

Some suggest that taxes based on income discourage saving, investment and entrepreneurial initiative because, unlike the case with other taxes, a portion of the anticipated increase in income is lost through increased taxes. They go on to suggest that these effects are more acute at the higher income levels where 50% or more of additional income is lost through additional income tax. They argue, further, that the overall growth of an economy is heavily dependent on savings, investment and entrepreneurial activity and that high marginal rates of income tax jeopardize overall economic growth. It is argued that this means, in turn, that all members of society experience negative effects from the income tax system, at least indirectly, even though their own initiative may not be directly affected by the tax system.

The degree of impact which income taxes have on personal initiative and the rates of taxation which must be reached before the impact is serious are subjective matters. It might be useful to consider an extreme example regarding the utilization of the income tax for illustrative purposes. It has been suggested that schools be totally funded by the provincial government, and that to replace the monies now raised through the property tax the provincial government should levy additional income taxes. To raise the $325 million now generated by the school property tax, the personal income tax would have to be increased by 27 percentage points of federal basic tax. In the previous section, it was noted that if the monies raised through the Saskatchewan flat tax were raised through the regular income tax, Saskatchewan's 1985 effective rate would be 59.0% of basic federal tax. Adding the additional 27 percentage points to this would yield a total rate of 86.0%. The Commission is of the view that personal income taxes at that level would not only be grossly out of line in relation to other provinces, but that they would have a substantial negative effect on personal and business initiative.

It is noteworthy that the flat tax, while not necessarily reducing the overall yield of taxes on income, does have a lower marginal rate than progressive income tax systems for middle and higher income groups. For this reason, the flat tax is generally regarded as being more compatible with the promotion of economic growth and development than the regular income tax. Whether the flat tax is as fair and equitable as income tax systems based on progressive rates is another question.

From the exclusive standpoint of personal and business initiative, it would be desirable to maintain or even increase property taxation rather than increase income taxation. However, the overall economic interests of society clearly must be balanced against the dictates of equity and fairness in the distribution of the costs of public services.

4. SUMMARY

With regard to considerations of equity and fairness, the Commission has concluded that:

- Taxes on income can be more equitable than taxes on sales or real property, particularly if the income tax system is reformed.
- There has already been a substantial shift from property taxes to income taxes over the past 15 years and the desirability of a further shift is questionable.
- The combination of the benefit principle and the distinction which some make between "services to people" and "services to property" is not useful in arriving at conclusions on which local governments should utilize the property tax.
- The Commission believes that it would be undesirable to tax property on physical rather than value measures of property.
- There is merit in shifting some of the tax load from property owners by expanding user charges for some services.
- There is merit in considering a gasoline tax as a user charge dedicated to the financing of the municipal transportation infrastructure, thereby lightening the load on the property owner for this service.

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* See "Appendix E" for the per capita rates of all provinces. Quebec and the Atlantic provinces have, on average, considerably lower per capita property taxes, largely because there is larger, or in some cases complete, provincial funding of education. These same provinces have either considerably higher personal income taxes or retail sales taxes or both.

** This is not to say that particular types of businesses are not affected differently by specific assessment policies in the respective provinces, and that some firms may enjoy an advantage while others incur a disadvantage relative to their counterparts in other provinces. The Commission simply notes that overall property tax levels in Saskatchewan do not place Saskatchewan businesses at a disadvantage.

- There should be a review of the relative property tax loads in rural and urban municipalities. Mechanisms are available to correct an imbalance if it exists.

With regard to considerations of administration and governance, the Commission has concluded that:

- Access to a substantial source of local revenue is very important for the autonomy of local governments.
- The nature of services delivered by municipalities and school divisions is such that considerable local decision-making is required in regard to the type or level of services to be provided in the respective jurisdictions. A substantial local source of revenue is required to enable local authorities to give effect to those decisions.
- Because local governments need equalization payments from the provincial government and because equalization payments must constitute a substantial portion of overall local government revenue in order to achieve their objectives, there are limits on the extent to which local revenues can replace provincial revenues.
- Because local governments are not in a position to finance major shortfalls between revenues and expenditures, they require a relatively stable source of revenue. The property tax is the most stable of the major tax sources.
- Use of a local source of revenue promotes accountability of local governments to those served.
- Although measures which limit the use of the local tax base may be feasible from a technical standpoint, they are in fundamental conflict with the principle of local autonomy.
- The utilization of the property tax base by a number of types of local governments creates additional complexity in taxation. This complexity would be considerably less if only one local government occupied the local tax base.
- The relative flexibility of different types of local government in varying expenditure levels in response to local economic circumstances is a legitimate consideration, but is not strong criterion for determining which local governments should occupy the property tax base.
- The provisions of the Constitution prevent a provincial government in Saskatchewan from removing separate schools from the property tax. It would be unsound policy to treat public school divisions differently than separate school divisions in regard to the use of the property tax.
- There are no tax sources other than the property tax which are feasible for use as substantial local sources of revenue.

With regard to considerations relating to the province's economic interests, the Commission has concluded that:

- A reduction in property taxes would cause a loss of monies from the provincial economy because of the payment of additional federal income taxes by farms and businesses which use property taxes as deductions in computing taxable income.
- When considering possible reductions in reliance on the property tax, the necessary increases in other taxes to replace the revenue, and the rates of taxation in other provinces with which Saskatchewan is in economic competition, need to be taken into account. Per capita property taxes are lower in Saskatchewan than all but one province west of Quebec.
- Excessive reliance on taxes based on income can have a negative effect on personal and business initiative.

The considerations in the Provincial Economic Interests group all support the maintenance or even increase in the use of property taxes relative to other forms of taxation. The considerations in the Administration and Governance group on balance strongly support the access of local governments to the property tax for a major source of their revenue, but are not in conflict with either an increase or decrease in the overall utilization of the property tax relative to other forms of taxation. The considerations in this Equity and Fairness group do not point strongly in any one direction.

The foregoing materials lead the Commission to the view that a perfect tax does not exist, and that a mix or balance among a number of revenue sources is required. It would, obviously, be inappropriate to identify the best tax and then endeavour to have the public sector rely exclusively on that one tax. This would neither meet the needs of various levels of government, nor would it be in the interests of equity and economic development.

Local governments do rely heavily upon one tax - the property tax. However, by virtue of the fact that the provincial government funds a substantial share of local government expenditures through grants and revenue sharing payments, local governments, in effect, are substantially financed from a broad set of tax bases including income taxes, consumption taxes and resource revenues.

It is also apparent to the Commission that a number of important considerations must enter into decisions on the appropriate degree of reliance on any one tax, and that caution must be exercised to ensure that judgments are not made in this regard on the basis of only one or two criteria when, in fact, there are numerous important considerations bearing on the matter.

CHAPTER IV
CONCLUSIONS/RECOMMENDATIONS

1. IN REGARD TO LOCAL TAXATION:

1.1 THE COMMISSION HAS CONCLUDED THAT THE PROPERTY TAX IS THE ONLY PRACTICAL LOCAL SOURCE OF REVENUE OF SUFFICIENT MAGNITUDE TO MEET THE NEEDS OF LOCAL GOVERNMENT.*

The Commission has examined a number of alternative local sources of revenue to see if they could be suitable replacements for either all or a major portion of the revenues that are currently raised through property taxation at the local level.

Although income taxes or sales taxes could generate large amounts of revenue, they are practical and feasible only as provincial and federal taxes, not as local taxes.

In order for a revenue source to be truly a local source, local governments must have the authority to set the rates of taxation for their own areas so as to match revenues with the needs and expectations of their respective publics. The setting of different rates for income or consumption taxes among the hundreds of local governments in Saskatchewan would create costly technical and administrative problems. Because of these costs and complexities, such revenue sources are not practical for use by local governments.

Various taxes based on income are the most frequently mentioned as possibilities for use as local taxes. Quite apart from technical problems and administrative costs, a local income tax would be unsuitable for local governments because of its instability. Local governments require stability in their revenue sources. The yield from income tax, particularly within a limited geographical area, can vary in a major way from year to year. Because of their relatively small financial base and their limited borrowing powers, all but the very largest local governments would not be in a position to cope with these variations in revenues.**

In short, if local governments are to have a substantial local source of revenue, the Commission has concluded that it must be the property tax.

Other local sources of revenue do exist, but their yield is such that they can only supplement, not replace, the property tax.

1.2 THE COMMISSION HAS CONCLUDED THAT A GREATER RELIANCE COULD BE PLACED ON USER CHARGES TO FINANCE CERTAIN PUBLIC SERVICES, THEREBY SERVING AS A SUPPLEMENT TO THE PROPERTY TAX.*

Examples identified by the Commission where there are opportunities for greater use of user charges and less reliance on property tax are:

- Communities incurring operating deficits in their water, sewer or transportation utilities could reduce or eliminate the deficits by increasing user charges, thereby reducing the extent to which the property tax must supplement those operations.
- Communities which use all, or a portion, of their unconditional provincial capital grants for utilities such as sewer and water projects, could use those grants for other municipal services, thereby reducing the amount required to be raised from the property tax for those other services. The capital cost of utilities could be financed to a greater extent from debentures and, in turn, the revenue necessary to retire the debentures could be raised through appropriate user charges.

The Commission believes that the following criteria should be used in determining whether or not a user charge should be implemented and the level of the service charge:

- User charges should be used only where the amount of use of the service can be readily quantified.
- User charges are particularly appropriate for financing services for which conservation in the use of the service is desired.
- User charges are either inappropriate or should be set at modest levels where the community interest would be served by greater use of the service.
- User charges should not be used as hidden taxes which are higher than required to finance the services in question.

There are numerous potential arrangements under which proceeds from provincial or federal taxes can be transferred to local governments, but there are not local sources of revenue. The Commission will deal with these later in this mandate.

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* Chapter II examines alternative local revenues in detail.
** See "Other Needs of Local Government", p. 19.

* See "Revenues Based on the Benefit Principle", p. 14.

2. *IN REGARD TO UTILIZATION OF THE PROPERTY TAX BASE:*

2.1 *THE COMMISSION HAS CONCLUDED THAT BOTH MUNICIPALITIES AND SCHOOL DIVISIONS SHOULD CONTINUE TO HAVE ACCESS TO THE PROPERTY TAX FOR A PORTION OF THEIR REVENUE.*

Municipal councils and school boards require a local source of revenue in order to discharge their respective mandates. They must make decisions on the level of services in their communities, the amount of resources allocated to those services and, in many instances, whether certain services are to be provided at all. The Commission notes that the desires of the public for the type and level of municipal and education services, as well as the level of taxation which they are prepared to bear in order to finance those desires, vary from community to community. Municipal councils and school boards require a source of revenue under their control, in order to respond to those local desires. As noted above, the property tax is the only practical local source of revenue of sufficient magnitude to meet the needs of local government.

The Commission notes that accountability for the use of public funds is promoted when local governments are required to finance part of their operations with local revenues.

In short, municipalities and school divisions require access to the property tax by virtue of the nature of the services for which they are responsible* and the need for independence or autonomy** in the discharge of their mandates in the provision of those services, and to promote responsible use of public funds.*** The property tax is a mainstay of local government.

The Commission regards the foregoing points as being sufficient to arrive at the conclusion that both municipalities and school divisions require continued access to the property tax. However, a number of arguments have been raised against the use of the property tax by school divisions, and the Commission believes it is important to address them:

1) Some say the property tax is unfair, that it should be reduced, and that removing schools from the property tax is the way to achieve that reduction. The Commission notes the following:
   - All taxes have weaknesses. Which tax is most fair is a highly subjective matter.****
   - If it is desirable to bring about a reduction in the level of property taxes equal to what school divisions now levy, this can be accomplished by increasing provincial payments to both municipalities and school divisions. This would avoid the negative consequences of leaving school divisions without a local source of revenue.
   - The fairness of the property tax can be improved by improving assessments,* and by the implementation of an income-based property tax credit program.**

2) It has been suggested that education property taxes create an inequitable rural/urban tax load and that, for this reason, education should be removed from the property tax.

   The Commission will be initiating a study of the rural/urban balance of tax loads.*** If an inappropriatebalance exists, there are means of correcting it without incurring the negative consequences of removing education from the property tax.

3) It has been argued that distinctions can be made between "services to people" and "services to property" and that in accordance with the benefit principle, only "services to property" should be financed from the property tax. Accordingly, it has been suggested that only municipalities should be financed from the property tax. The Commission notes the following:
   - The terms "services to people" and "services to property" are misleading because ultimately all services are intended to benefit people.
   - Substantial municipal expenditures (perhaps the majority, particularly for urban municipalities) are made on services which benefit people in the community as a whole, rather than on services which benefit people by virtue of the nature and amount of property they own or rent.
   - The amount of property tax raised from parcels of property bears little relationship to the benefits from municipal services received by the owners or renters of those respective parcels of property.

   In short, "services to people" and "services to property" are not helpful concepts in considering which local governments should utilize the property tax.****

4) It has been suggested that issues such as the rural/urban balance in tax loads, equalization of assessments, the governance of the assessment function, and arriving at appropriate local tax loads***** would either disapppear or would be less complex if education were not financed from the property tax.

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* See "Types of Locally Delivered Services", p. 17.
** See "Autonomy", p. 16. See also pp. 24 to 30 and 33 to 34 of the January, 1985 *Interim Report*.
*** See Accountability to the Taxpayer", p. 19.
**** See "Relative Equity of Different Forms of Taxation", p. 9.

* See *Property Assessment in Saskatchewan*, a Commission report on assessment released concurrently with this report. See also Conclusion/Recommendation #6.
** See Conclusion/Recommendation #3.
*** See Conclusion/Recommendation #7.
**** See "Benefit and Ability to Pay Principles", p. 11.
***** See "Complexity: Multiple Taxing Authorities", p. 20.

The Commission recognizes that some issues would cease to exist or become less complex if schools were not financed from the property tax, but believes that other reasons for retaining the school property tax are more compelling. The Commission also notes that numerous issues such as the level of taxation of downtown versus highway commercial properties, the tax load on light soils relative to other soils, and whether the business tax is a form of double taxation, would remain as issues, even if schools were not financed from the property tax.

The Commission also believes that the removal of separate school divisions from the property tax would be contrary to constitutional guarantees, and it would be inappropriate for the provincial government to treat public schools differently in this respect.*

Although the Commission has concluded that both municipalities and school divisions should continue to have access to the property tax for a portion of their revenues, the overall level of utilization of the property tax and the degree to which each type of local government should be required to rely on the property tax are separate questions which the Commission plans to address in a future report.

It could be argued that while certain people need relief from property taxation from time to time, the overall level of property taxation is not out of line in relation to other forms of taxation. The main factors that could be used in support of this argument are:

1) Property taxes now consume a smaller percentage of Saskatchewan's total income than they did 15 years ago, whereas income taxes consume a larger portion of total income.** It could be suggested that the desirability of financing a general reduction in property taxes by means of an increase in income tax, considering the substantial shift that has already taken place toward the income tax, is questionable, at least at present.

2) Property taxes in Saskatchewan are not out of line with other provinces on an overall per capita basis. Of the 5 westernmost provinces, Saskatchewan is virtually tied with Ontario for the lowest at $497 and $496 per capita, respectively, and British Columbia is the highest at $569 per capita. Manitoba has $504 per capita in property taxes, and Alberta has $531 per capita.*** These figures do not take into account the net effect of rebate programs in the various provinces.

3) The property tax is projected to yield $625 million for local governments in 1985. Only two revenue sources yield comparable revenues for the provincial government: oil revenues are projected to yield $655 million, and individual income taxes are projected to yield $626 million in 1985-86. Sales taxes are projected to yield $383 million and corporation income taxes are projected to yield $145 million.

It could be argued that, if a major reduction were to be made in the property tax, corresponding major increases would have to be made in provincial taxes to bring it about and that at present, such increases would tend to put those tax rates out of line with other provinces.* It could also be noted that the income tax is already relied upon more heavily in Saskatchewan than in other western provinces.**

On the other hand, the Commission also wishes to note the following:

- Reforms might be made to the income tax structure to make it decidedly more fair and equitable. As a result, there may be merit in increasing a reformed provincial income tax, increasing provincial government transfer payments to local governments, and reducing the property taxes required by local governments.
- Overall provincial government revenues may improve in the future to the point where substantial increases in transfer payments to local governments could be made without putting other Saskatchewan tax rates out of line with other provinces.
- The Commission plans to review the revenue sharing concept, the formulas used to distribute provincial transfer payments to municipalities, capital needs of local government, and the dedicated tax concept*** in a future report. The Commission also plans to do a thorough analysis of the option of having the provincial government finance up to 75% or 80% of education costs.****

The conclusions arising from these reviews may point to the need for a different level of senior government fiscal transfers to local governments and a different level of reliance on the property tax, relative to other taxes.

2.2 *THE COMMISSION RECOMMENDS THAT LOCAL TAXING AUTHORITIES BE REQUIRED TO MAKE GREATER DISTINCTION BETWEEN SCHOOL AND MUNICIPAL LEVIES IN TAX NOTICES, SO AS TO IMPROVE PUBLIC UNDERSTANDING OF TAXATION DECISIONS AND TO PROMOTE ACCOUNTABILITY BY MUNICIPAL AND SCHOOL REPRESENTATIVES TO THE TAXPAYER.*

In most instances, there is insufficient distinction between the different components of the total levy included in the tax notices sent from municipal offices. Consequently,

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* See "Constitutional Considerations", p. 21.
** See "Trends in the Utilization of the Property Tax", p. 11.
*** See "Inter-Provincial Comparison of Tax Rates", p. 22, and Appendix E.

* See "Inter-Provincial Comparison of Tax Rates," p. 22
** See "Personal and Business Initiative", p. 24.
*** See Conclusion/Recommendation #4.
**** See Conclusion/Recommendation #5.

public understanding of taxation decisions is impaired, municipal authorities are often held accountable for decisions which are not theirs, and overall accountability is impaired. In particular, the school component of the total tax levy should be highlighted in a more distinct fashion.

The Commission favours the sending of a single tax notice from the municipal office, with the notice designed in such a way that the components of the levy are highlighted more effectively. The Commission also favours having the previous year's levies in dollars included in the notice so that the taxpayer is able to determine which components account for the changes in total tax levels.*

The Commission considered, but did not agree with the offer of school divisions to levy and collect their own property taxes. While this would improve accountability, it would create unnecessary additional administrative expenses.

3. *THE COMMISSION HAS CONCLUDED THAT A SELECTIVE FORM OF PROPERTY TAX RELIEF IS REQUIRED FOR THOSE FOR WHOM PROPERTY TAXES ARE AN UNDUE BURDEN, AND REITERATES ITS RECOMMENDATION FOR AN INCOME-BASED PROPERTY TAX CREDIT PROGRAM.***

The Commission notes that the Government of Saskatchewan has already announced the introduction of an income-based property tax credit program for senior citizens.

The main reasons why the Commission supports a general income-based property tax credit program are:

1) The property tax is insensitive to changes in the capacity of the property owner to pay those taxes at a particular point in time. The proposed income-based property tax credit will alleviate the burden of property taxes on those whose incomes are chronically low and on those who have experienced short-term reductions in their capacity to pay.

   When a person has difficulty in paying property taxes, the payment of a dollar in municipal tax is equally difficult as the payment of a dollar in school tax. Therefore, when relief from property tax is required, the relief must apply to both the municipal and school portions.

2) At the lower end of the income scale, the property tax tends to be regressive because a higher proportion of the incomes of low income-earners usually go towards the payment of property taxes than for higher income-earners. An income-based property tax credit would provide compensation for this deficiency.

3) Selective property tax relief is efficient because it provides assistance only to those who need it. There may be reasons why there should be increased provincial transfer payments to local governments. However, as a means of providing relief from property taxes, increased transfers to local governments could be regarded as a less efficient mechanism because the tax would be reduced on all property whether or not the payer of the property tax requires such relief.

4) By targetting the tax relief to those with chronically or temporarily low incomes, outflows of monies through the federal income tax system will be minimized. Only those farms and businesses which claim property taxes as business deductions, and pay no income taxes or which have low marginal rates of taxation, would receive the assistance.*

   The Commission believes that if there were a general reduction in property tax, it would reduce but by no means eliminate the need for the proposed income-based property tax credit program.

4. *THE COMMISSION HAS CONCLUDED THAT A REVIEW SHOULD BE DONE ON THE CONCEPT OF SPECIFIC TAXES OR PORTIONS OF SPECIFIC PROVINCIAL TAX BASES BEING DEDICATED TO THE FUNDING OF LOCAL GOVERNMENT SERVICES.*

The Commission is not suggesting by this particular conclusion that the overall amount of fiscal transfers from provincial government revenue sources to local governments should either be increased or decreased. The question is whether such transfers, whatever their level may be, should continue to be made out of general provincial government revenues, or whether specific revenue bases should be earmarked or dedicated as the source from which payments will be made.

The Commission has decided that a review of this concept should be undertaken for the following reasons:

- It may provide the general public with a greater understanding about the use of their tax monies.

  Because of increased public understanding, it may increase accountability of local governments for the use of revenues reserved from provincial sources.

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* An example of a stylized revised tax notice is included as "Appendix F".

** See pp. 37 to 41 of the January, 1985 *Interim Report* for an outline of this recommendation for a "refundable income tax credit", as it was termed in that report.

* See "Inflows/Outflows of Monies from Saskatchewan", p. 22.

- There may be ways to involve local governments in decisions on the rates of taxation to be applied to the dedicated taxes, thereby promoting shared responsibility and possibly accountability for public funds.
- There may be revenue sources that can be practically administered only at the provincial level, but which may have a relationship with local services. Fuel taxes used to support municipal transportation expenditures may be an example of such a revenue source.

5. *THE COMMISSION HAS CONCLUDED THAT A REVIEW SHOULD BE DONE ON THE POSSIBILITY OF THE PROVINCIAL GOVERNMENT FINANCING 75% TO 80% OF EDUCATION EXPENDITURES.*

It has been suggested that this option might be a possible approach to achieving consensus among local governments on the utilization of the property tax base.

The S.S.T.A. has indicated that it would be prepared to accept up to 75% or 80% provincial funding, but has emphasized that this would be the maximum level acceptable to their organization. They believe that provincial funding in excess of 75% to 80% would jeopardize the autonomy of school divisions.

In a combination of individual and joint briefs to the Commission, all cities in Saskatchewan, with the exception of Moose Jaw and Swift Current, have indicated their support for schools using the property tax for discretionary expenditures with the provincial government financing basic expenditures.The cities did not indicate, however, what percentage of school expenditures fell into the discretionary and basic categories.

The positions of S.A.R.M. and S.U.M.A., as reflected in their respective convention resolutions, are that no portion of school expenditures should be financed from the property tax.

The Commission recognizes that considering the various positions of local governments and their parent organizations, the prospects for achieving that consensus are quite speculative.If the option can be a focal point for possible consensus and if for other reasons it is compatible with the general public interest, the Commission believes it should be fully explored.

6. *THE COMMISSION HAS CONCLUDED THAT A MAJOR OVERHAUL OF THE SASKATCHEWAN ASSESSMENT SYSTEM IS REQUIRED.*

The Commission has outlined the reasons for this conclusion and has made recommendations to address the current problems in a separate report.*

* See *Property Assessment in Saskatchewan*, another report issued by the Commission concurrently with this report.

7. *THE COMMISSION HAS CONCLUDED THAT A REVIEW IS REQUIRED OF THE RESPECTIVE SHARES OF THE PROPERTY TAX LOAD NOW BEING BORNE BY TAXPAYERS IN URBAN AND RURAL MUNICIPALITIES.**

One of the major concerns that has arisen in regard to the financing of services like education from the property tax is that there may be an inappropriate distribution of the tax load on agricultural property on the one hand, and non-agricultural property on the other hand. The Commission is of the opinion that the assessment system will not necessarily automatically produce values which will bring about a desired distribution of the tax load. Accordingly, the Commission plans to initiate a study in this area.

If a review revealed an inappropriate distribution of burden, there are two possible ways to make adjustments and accomplish the desired balance which the Commission has identified thus far:

- Authorities that tax both urban and rural municipalities could be required to have a certain percentage differential in their rural and urban mill rates.
- The percentage of appraised value that is used for arriving at assessed values can and do differ among different classes of property. These differences can be set such that a standard mill rate applied to rural and urban properties yields the desired overall urban/rural balance.

CONCLUSION

The Commission has undertaken a thorough analysis of alternative local sources of revenue and has carefully examined every significant consideration it was able to identify regarding the utilization of the property tax.

The Commission has concluded that the property tax plays an important role that no other local revenue source can feasibly play for local governments, and that both municipalities and school divisions require continued access to the property tax for a portion of their revenues. The Commission has also reiterated its proposal for an income-based property tax credit program. This proposed program will address a major shortcoming of the property tax and will result in considerably more equity in the overall tax system.

These conclusions are important in and of themselves. They also establish a foundation upon which the Commission can proceed to address other matters to be dealt with durings its mandate.

* See *Property Assessment in Saskatchewan*, another report issued by the Commission concurrently with this report.

APPENDIX A
Saskatchewan Flat Tax

The recently introduced Saskatchewan flat tax represents a departure from the traditional approach used to tax personal income. While both are income taxes, the definition and magnitude of the tax bases are quite different.

Traditional personal income tax system:

The provincial personal income tax is calculated as a percentage tax rate on basic federal tax. In effect, the provincial tax is levied on the amount of federal tax payable.

Flat tax:

The flat tax is calculated as a percentage of the individual's net income, well before the regular amount of federal and provincial income taxes are calculated.

An explanation of how the different types of income taxes are determined is provided below:

Total income is the sum of income from employment and self- employment (farming, business, etc.) less employment related expenses, plus pension and other income.

Net income is total income, less deductions for contributions to the Canada Pension Plan, Unemployment Insurance premiums, pension and retirement savings plans, union dues, child-care expenses, and allowable business investment losses.

The flat tax is determined by multiplying net income by a provincial tax rate.

In calculating the traditional income tax, net income is further reduced by a series of personal and other deductions in order to obtain taxable income. These deductions include personal and married exemptions, exemptions for dependent children, medical expenses, charitable donations, and pension and interest/dividend/capital gains deductions.

The basic federal tax is determined by multiplying taxable income by the federal tax rates.

The traditional provincial income tax is determined by multiplying the federal basic tax by a provincial tax rate.

Both the flat tax and the regular income are eligible for the Saskatchewan tax reductions which effectively eliminate the flat tax for those people earning less than $10,000. Both taxes are also subject to a surtax which effectively increases the amount of tax payable for high income-earners.

Because the flat tax is levied on net income before allowable deductions for personal expenses, dependent children, medical, charitable contributions and other expenses, the tax base is substantially larger than the regular tax base. Fewer allowable deductions means that a 1% flat tax will yield considerably more revenue than a 1% regular provincial income tax. The differences in allowable deductions also means there will be differences in the impact on the distribution of the tax burden among taxfilers.

Local Government Finance Commission
September, 1985

APPENDIX B

Average v.s. Marginal Tax Rates: Some Inter-Provincial Comparisons

TOTAL INCOME TAXABLE INCOME	$15,000 $ 4,760(1)			$25,000 $14,368(1)			$35,000 $24,368(1)		
Province	Tax Payable	Average(3) Tax Rate	Marginal(4) Tax Rate	Tax Payable	Average Tax Rate	Marginal Tax Rate	Tax Payable	Average Tax Rate	Marginal Tax Rate
Newfoundland	$392	8.2%	10.2%	$1,476	10.3%	12.0%	$2,801	11.5%	15.0%
Prince Edward Is.	343	7.2	8.9	1,291	9.0	10.5	2,450	10.1	13.1
Nova Scotia	369	7.8	9.6	1,390	9.7	11.3	2,637	10.8	14.1
New Brunswick	379	8.0	9.9	1,427	9.9	11.6	2,707	11.1	14.5
Quebec	453	11.9	17.0	2,058	15.4	23.0	4,094	17.6	26.0
Ontario	314	6.6	8.2	1,181	8.2	9.6	2,240	9.2	12.0
Manitoba	281	5.9	7.3	1,328	9.2	10.8	2,520	10.3	13.5
Saskatchewan(2)	117	2.5	3.0	1,360	9.5	11.0	2,425	10.0	13.5
Alberta	87	1.8	2.2	1,070	7.4	8.7	2,030	8.3	10.9
British Columbia	311	6.5	8.1	1,169	8.1	9.5	2,218	9.1	11.9

Notes: The table is based upon a taxpayer claiming a spouse and two children (one child aged 6 or under and an older child aged 12-15). Total income includes earned income and family allowance payments. Personal exemptions, employment expense deductions, C.P.P./Q.P.P. and U.I. contributions are deducted in computing the tax payable. Provincial tax reductions and surtaxes are included, except for property tax credits.

(1) The corresponding taxable income figures for Quebec are $3,797, $13,322 and $23,322, respectively.

(2) The figures for Saskatchewan include the reduction of the personal income tax from 51% to 50% of basic federal tax, and the imposition of the 1% flat tax, both of which were effective on July 1, 1985.

(3) The average tax rate is the amount of tax payable as a percentage of taxable income.

(4) The marginal tax rate is the percentage tax rate levied on one additional dollar of income at the level of total and taxable income indicated. For example, if the Saskatchewan taxpayer who earns $35,000 in total income were to earn an additional dollar, he would be required to pay an additional 13.5¢ in provincial personal income tax. His marginal rate of provincial personal income tax at that level of income is 13.5%.

Sources: Department of Finance; 1985 Budget Address.

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APPENDIX C

Revenue Yield of One Percentage Point on Major Saskatchewan Tax Bases

Tax and 1985 Tax Rates	Value of One Percentage Point
Personal Income Tax	
General - 50 1/2% of basic federal tax (1)	$ 12.1 million
Flat tax - 1/2% of net income (2)	$107.0 million
Corporate Income Tax	
General - 16% of taxable income	$ 7.9 million
Small Business - 10% of taxable income	$ 2.6 million
Education & Health Tax	
5% of retail sales price	$ 67.4 million

Notes: (1) The general personal income tax rate will be 50% in 1986.

(2) The flat tax rate will be 1% in 1986. The gross annual yield for the flat tax is before the Saskatchewan tax reduction and surtax and excludes the reduction in the general rate.

Source: Department of Finance

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APPENDIX D

Inter-Provincial Comparison of 1985 Rates for Major Taxes

Province	Personal Income Tax	Corporate Income Tax: Small Business Rate	Corporate Income Tax: General Rate	Retail Sales Tax	Gasoline Tax
B.C.	44.0%	8.0%	16.0%	7.0%	20.0%
Alta.	43.5	5.0	11.0	-	
Sask.	50.5	10.0	16.0	5.0	-
Man.	54.0	10.0	16.0	6.0	8¢/litre
Ont.	48.0	-	15.0	7.0	20.0
Que.	*	3.0	5.5	9.0	30.0
N.B.	58.0	9.0	15.0	11.0	20.0
N.S.	56.5	10.0	15.0	10.0	20.0
P.E.I.	52.5	-	10.0	10.0	20.0
Nfld.	60.0	10.0	16.0	12.0	22.0

* Quebec administers its own personal income taxes, using its own set of rules governing what constitutes income, allowable deductions, rates of progression, etc., and for this reason, its rates are not comparable to other provinces. All other provinces have the federal government collect the income tax for them using standard federal rules, and all taxes are expressed as percentages of federal basic taxes.

Although rates cannot be directly compared, it is clear that personal income taxes in Quebec are considerably higher than in Saskatchewan. For example, a taxpayer with a total income of $35,000 and claiming a spouse and two children pays $2,425 in Saskatchewan and $4,094 in Quebec, a difference of 69%.

Source: Department of Finance

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APPENDIX E

Inter-Provincial Comparison of Per Capita Property Taxation(1)

Province	Total Property Tax ($000)	Per Capita Property Tax ($)
Newfoundland	46,715	82.17
Prince Edward Island	21,833	177.94
Nova Scotia	199,751	234.53
New Brunswick	163,832	234.41
Quebec	2,030,513	313.36
Ontario	4,320,273	495.67
Manitoba	521,659	504.26
Saskatchewan	486,324	496.71
Alberta	1,231,977	531.37
British Columbia	1,588,528	569.14
TOTAL	10,630,670	431.58

(1) All figures are for 1982

Source: Statistics Canada

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APPENDIX F

198__ TAX NOTICE

NAME

ADDRESS

Reading Instructions

PROPERTY DESCRIPTION	ASSESSMENT INFORMATION
1	1
2	2
3	3
4	4

MUNICIPAL
Local Improvement Charge + (Assessment x Mill Rate)

1
2
3
4

Previous Year's Taxes

Current Year's Taxes

Total Municipal

+

SCHOOL (Assessment x Mill Rate)

1
2
3
4

Total School

+

OTHER

(Assessment x Mill Rate)

1
2
3
4

(Assessment x Mill Rate)

1
2
3
4

Total Other

TOTAL

1
2
3
4

Total Current Year's Taxes

+

Penalties Plus

Arrears

+

Total Taxes

Payable

PAYMENT INSTRUCTIONS

Discounts, Penalty information